FRAUD & NEGLIGENCE

District Court Rules That Where There's No Will, There's a Way to Avoid FBAR Penalties

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"Ignorance of the law" may indeed be an excuse where willfulness is a necessary element, but the passage of time, combined with the government's publicizing of its efforts to eliminate noncompliance with reporting of offshore accounts, may make such an argument ineffective in the future. Nevertheless, a recent case finding the taxpayer's noncompliance was not willful may continue to resonate for several other reasons.

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In recent years, newspapers and tax journals have contained articles about international tax issues, particularly the duty of U.S. persons to file an annual Form TD F 90-22.1 (FBAR) to disclose their interest in foreign financial accounts. This was not always the case; before the public scandal centered on UBS in Switzerland, the FBAR was an obscure form with little significance to most taxpayers and practitioners. [1] This generalized ignorance of the FBAR, combined with other factors, resulted in little historic enforcement. One congressional report indicated that from 1993 to 2002, the U.S. government considered asserting FBAR penalties in just 12 cases. Of those dozen, only two taxpayers ultimately received penalties, four were issued "letters of warning," and the remaining six were not pursued for various reasons. [2]

Times have changed. The FBAR's profile has now increased, thanks to the UBS controversy, various pseudo-amnesty programs over the last few years (including the Offshore Voluntary Compliance Initiative, Last Chance Compliance Initiative, and the Offshore Voluntary Disclosure Program announced by the IRS on 3/23/09), [3] along with numerous guilty pleas, news of which the Department of Justice disseminated (and applauded). As generalized knowledge of the FBAR filing requirement increases, the chances of taxpayers' avoiding penalties on grounds that they did not act "willfully" decreases. [4] Nevertheless, one recent case fought before both the Tax Court and a district court—*Williams,* 131 TC 54 (2008), and 106 AFTR 2d 2010-6150 (DC Va., 2010)—offers support for the proposition that where there's no will, there's a way to avoid harsh FBAR penalties. It also provides valuable insight into the world of modern FBAR enforcement.

FBAR RULES AND PENALTIES—OVERVIEW

To fully appreciate the relevance of the Tax Court case (*Williams I*) and the district court case (*Williams II*), one must first understand the applicable law.

Congress enacted the Bank Secrecy Act in 1970. [5] 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. [6] Among the important provisions of the Bank Secrecy Act is 31 U.S.C. section 5314. This statute, in conjunction with the underlying regulations and FBAR instructions, requires the filing of an annual FBAR where (1) a U.S. person (2) had a financial interest in, signature authority over, or other authority over (3) one or more financial accounts (4) located in a foreign country, (5) the aggregate value of which exceeded $10,000 (6) at any time during the calendar year. [7]

Concerned with widespread noncompliance with the FBAR requirement, the U.S. government took certain actions. For instance, Treasury transferred authority to enforce the FBAR provisions from the Financial Crimes Enforcement Network ("FinCEN") to the IRS in April 2003. [8] The latter is now empowered to investigate potential violations, issue summonses, assess civil penalties, issue administrative rulings, and take "any other action reasonably necessary" to enforce the FBAR rules. [9]

Congress, for its part, enacted new FBAR penalty provisions in October 2004 as part of the American Jobs Creation Act (AJCA). Under the old law, which was applicable to the taxpayer in *Williams I* and *II,* the government could assert a civil penalty only where a taxpayer "willfully" violated the FBAR rules. [10] Meeting this burden was challenging, as it required the government to demonstrate that the taxpayer knew about the FBAR-related duties, yet intentionally ignored them. [11] If the government managed to satisfy this high evidentiary standard, it was authorized to assert penalties ranging from $25,000 to $100,000, depending on the highest balance of the relevant account(s). [12]

As a result of the AJCA, the Service may now impose a civil penalty on any person who fails to file an FBAR when required, period. [13] In the case of non-willful or unintentional violations, the maximum penalty is $10,000. [14] The IRS cannot assert this penalty, however, if two conditions are met: the violation was due to "reasonable cause" and the balance in the account was properly reported. [15]

The AJCA calls for a higher maximum penalty where willfulness exists. Where a taxpayer deliberately failed to file an FBAR, the Service may assert a penalty equal to $100,000 or 50% of the balance in the account at the time of the violation, whichever amount is larger. [16]

WILLIAMS I AND II—A TALE OF TWO COURTS

A synthesis of the various court documents and decisions yields the facts underlying the *Williams* cases. [17]

The taxpayer was a U.S. citizen at all relevant times. He earned an undergraduate degree from University of North Carolina, followed by a law degree from New York University. He began his legal career as an associate with a major international law firm. He later worked for Mobil Oil, where he held various legal and business positions over a span of some 25 years.

In 1991, the taxpayer, on Mobil's behalf, started exploring strategic business opportunities in the former republics of the Soviet Union. Two years later, in 1993, the taxpayer opened two accounts at Credit Agricole Indosuez, S.A. (then known as Banque Indosuez) in the name of ALQI Holdings, Ltd., a British Virgin Islands corporation, which he controlled. The accounts were designed to hold funds received by the taxpayer from 1993 through 2000 in connection with his oil trading in Russia and his consulting for various companies under the guise of ALQI. During this eight-year period, the taxpayer deposited more than $7 million into the accounts, and the funds generated approximately $800,000 in passive income. The taxpayer neither reported this income on his annual Form 1040 nor filed an FBAR declaring his interest in the foreign accounts.

In August 2000, Swiss government officials notified the taxpayer of its desire to interview him with respect to the ALQI accounts. The Swiss authorities, who were apparently coordinating with their U.S. counterparts, interviewed the taxpayer on 11/13/00. The next day, the U.S. government directed Switzerland to freeze the accounts. It did so.

In early June 2001, the taxpayer retained U.S. tax attorneys at a reputable national firm to advise him with respect to the ALQI accounts. They provided no instructions or advice to the taxpayer about the requirement to file an FBAR for the 2000 calendar year by 6/30/01. The taxpayer's attorneys later met with IRS attorneys in January 2002 to discuss a possible resolution of the taxpayer's case on a noncriminal basis.

The IRS announced a tax amnesty program, the Offshore Voluntary Compliance Initiative (OVCI), in January 2003. [18] The OVCI offered lenient settlement terms to those who came forward. Provided that a taxpayer was eligible for the OVCI, he could essentially resolve *all* past international tax noncompliance in a criminal-free manner, with relatively small civil penalties. In essence, a taxpayer had to file amended federal income tax returns (i.e., Forms 1040X) for 1999, 2000, and 2001 reporting all foreign-source income, pay the corresponding taxes and interest charges, and file all necessary information returns related to foreign entities and accounts, such as the FBAR. Perhaps that most appealing aspect of participating in the OVCI was that the IRS treated this as a "voluntary disclosure." This meant that the IRS generally would not pursue any criminal charges. [19]

The taxpayer, enticed by this offer, submitted his OVCI application in February 2003. The Service rejected his approach in April 2003, citing the fact that the OVCI was not available to taxpayers whose applications arrived after the IRS already had initiated a civil examination or criminal investigation of the taxpayer or a related entity, after the IRS had notified the taxpayer of its intent to start such an examination or investigation, or after the IRS received information from a third party, including another governmental agency, alerting the IRS to the offshore noncompliance. [20]

In May 2003, the taxpayer agreed to plead guilty to one count of criminal tax evasion and one count of criminal conspiracy to defraud the U.S. government. This plea agreement was confirmed on 6/12/03, when the taxpayer made the following statement:

"In 1993, with the assistance of a banker at Bank Indosuez, I opened two bank accounts in the name of a corporation ALQI Holdings, Ltd. ALQI was created at the time as a British Virgin Islands Corporation. The purpose of that account was to hold the funds and income I received from foreign sources during the years 1993 through 2000. Between 1993 and 2000, more than seven million dollars was deposited in the ALQI accounts and more than $800,000 income was earned on those deposits. I knew that most of the funds deposited into the ALQI accounts and all of the interest income were taxable to me. However, [in] calendar year returns '93 through 2000, I chose not to report the income to my — to the Internal Revenue Service in order to evade substantial taxes owed thereon, until I filed my 2001 tax return.... I knew what I was doing was wrong and unlawful. I, therefore, believe that I am guilty of evading the payment of taxes for the tax years 1993 through 2000. I also believe that I acted in concert with others to create a mechanism, the ALQI accounts, which I intended to allow me to escape detection by the IRS. Therefore, I am — I believe that I'm guilty of conspiring with the people would [sic] whom I dealt with regarding the ALQI accounts to defraud the United States of taxes which I owed."

At the sentencing hearing in September 2003, the court imposed the following punishment on the taxpayer: nearly four years in jail, a $25,000 fine, over $3.5 million in restitution, and three years of supervised release. The court also ordered that all the assets in the unreported Swiss accounts be transferred to the clerk of the court for payment of the fine, restitution, etc. Thus, more than $8 million was transferred to the U.S. government at that time.

The FBAR penalties. The Service then initiated a civil examination. As part of this process, the revenue agent indicated that he would not conclude the examination until the taxpayer had filed FBARs for all years going back to 1993. The taxpayer did so. According to the taxpayer, the revenue agent initially threatened to assert FBAR penalties for *each* year from 1993 through 2000 unless the taxpayer agreed to execute the proposed examination report. The taxpayer refused to execute the report because he believed it was "grossly incorrect," and after the taxpayer's counsel explained to the revenue agent that he was precluded from asserting a civil FBAR penalty for 1993 through 1999 because the six-year statute of limitations had passed, the revenue agent imposed the maximum penalty of $100,000 per account for the two ALQI accounts on grounds that the taxpayer "willfully" failed to file an FBAR for 2000. The revenue agent asserted this FBAR penalty of $200,000 on 5/17/07.

In addition to asserting the FBAR penalty, the IRS issued a notice of deficiency on 10/29/07, proposing significant federal income tax deficiencies, accuracy-related penalties, and civil fraud penalties for all eight years, 1993 through 2000.

Income Tax Deficiencies and Penalties—Tax Court

The taxpayer filed a timely petition with the Tax Court contesting all the proposed adjustments set forth in the notice of deficiency, as well as the FBAR penalties that were not included therein. The IRS filed a motion to dismiss for lack of jurisdiction as to the FBAR penalties. [21]

The Service's theory was that the provision under which FBAR penalties are asserted (i.e., 31 U.S.C. section 5321) does not fall within the Tax Court's jurisdiction. This is based on Section 7422, which provides that the Tax Court and its divisions "shall have such jurisdiction as is conferred on them by this title..." (i.e., the Internal Revenue Code, which is Title 26 of the United States Code).

The Tax Court began the opinion in *Williams I* by explaining that Section 6212(a) authorizes the IRS to issue a notice of deficiency in certain situations. Section 6213(a) provides that the tax in question may not be assessed until the IRS has issued the requisite deficiency notice. It further provides that the tax assessment must be delayed pending a possible redetermination by the Tax Court if the taxpayer files a timely petition.

The Tax Court pointed out, however, that these two provisions expressly state that the notice of deficiency is to be sent in the case of taxes imposed by Subtitle A of Title 26 (i.e., income taxes), Subtitle B of Title 26 (i.e., estate and gift taxes), or Chapters 41, 42, 43, or 44 in Subtitle D of Title 26 (i.e., miscellaneous excise taxes). Therefore, by negative implication, any other taxes fall outside the limited jurisdiction of the Tax Court. Extending this logic, the Tax Court reasoned as follows with respect to FBAR penalties:

"The same conclusion must be reached as to the FBAR penalties imposed in Title 31: The Secretary of the Treasury is authorized by 31 U.S.C. sec. 5321(b)(1) to assess the FBAR penalty; no notice of deficiency is authorized by section 6212(a) nor required by section 6213(a) before that assessment may be made; and the penalty therefore falls outside our jurisdiction to review deficiency determinations."

The issue of whether the Tax Court would have jurisdiction over a subsequent action by the government to *collect* FBAR penalties was not raised in the taxpayer's petition in *Williams I,* and was not broached in the Service's motion to dismiss. Nevertheless, the Tax Court addressed this topic on its own.

A brief overview on the normal tax collection process helps put this second issue in context. The IRS is required to send the taxpayer a notice of intent to levy at least 30 days before it seizes his property to satisfy tax debts. [22] To dispute the intended governmental taking, a taxpayer may file a Form 12153, which triggers a collection due process (CDP) hearing. [23]

At the CDP hearing, the IRS settlement officer is charged with deciding whether the levy "balances the need for efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary." [24] The settlement officer ultimately issues a notice of determination, which represents the Service's final administrative decision regarding the propriety of the levy.

If the notice of determination upholds the levy, the taxpayer may seek further review, this time from the judiciary. He exercises this right by filing a petition with the Tax Court. [25]

In *Williams I,* the Tax Court explained that the provisions under which the IRS may place a lien or effectuate a levy are narrow. They apply only to "taxes," as well as the additions to tax, additional amounts, and penalties described in Chapter 68 of Title 26 (i.e., Sections 6651 through 6751). [26] The Tax Court then made three points as to why it would lack jurisdiction to address any FBAR-penalty-collection issue:

> (1) There is no statute expanding the definition of "tax" as used in the lien and levy provisions of the Code to include the FBAR penalty.
> (2) The collection mechanism in the applicable FBAR statute, 31 U.S.C. section 5321(b)(2), is not a lien or levy, but rather a "civil action to recover a civil penalty."
> (3) Even if the FBAR penalty were a tax subject to the Service's lien and levy provisions, the IRS had not issued a notice of determination, which is a prerequisite to filing a petition with the Tax Court.

In summary, the Tax Court held in *Williams I* that it lacked jurisdiction to address FBAR issues at the assessment and collection stages. [27]

FBAR Penalty Collection Action—District Court

Predictably, the taxpayer did not hand over the $200,000 to the IRS after the revenue agent asserted the maximum penalty in May 2007. He took the position that he did not "willfully" fail to file an FBAR for 2000, so the penalty could not apply. The government, therefore, filed a complaint in district court in April 2009. The government did so pursuant to 31 U.S.C. section 5321(b)(2), which provides that the government may commence a civil action to recover an FBAR penalty within two years of the date on which it was assessed.

Motion for summary judgment. The government then filed a motion for summary judgment (MSJ) on the FBAR penalty issue, with the focus being whether the taxpayer "willfully" failed to file an FBAR for 2000. The government, citing *Ratzlaf v. U.S.,* 510 US 135, 126 L Ed 2d 615 (1994), and *U.S. v. Sturman,* 951 F2d 1466 (CA-6, 1991), argued that it only needed to prove that the taxpayer intentionally violated "a known legal duty" to prevail.

Referring to his earlier guilty plea in 2003, the government maintained that the taxpayer already had admitted in the criminal trial that he knew he had an obligation to report the existence of the Swiss accounts, he knew that the foreign source income deposited into and generated by such accounts constituted taxable income to him, and he knew that he was conspiring with others to escape detection by the IRS. Thus, reasoned the government, the taxpayer acted "willfully" in not filing the FBAR.

In a subsequent brief on the issue, the government contended that the taxpayer's plea of guilty to the criminal charges had the "collateral consequence" of subjecting him to a $200,000 civil FBAR penalty. The government also claimed that the taxpayer was trying to "have his cake and eat it too" by making a statement at the criminal trial in order to obtain a reduced sentence for acceptance of responsibility, and then attempting to avoid civil penalties by retracting his statements.

The district court was not persuaded by the government's argument. In rejecting its MSJ, the court made two main points. First, the court noted that the primary issue—whether the taxpayer "willfully" failed to file an FBAR with respect to his Swiss accounts existing in 2000—was an "inherently factual question" that was inappropriate for summary judgment.

Second, while acknowledging that the taxpayer generally cannot disaffirm in a subsequent civil action the facts underlying an earlier guilty plea, the court explained that the real issue in *Williams II* was defining which specific facts were actually part of the taxpayer's plea in 2003. The taxpayer previously admitted that he intentionally omitted income from his tax returns for 1993 through 2000, but "there is a disconnect between this broad factual basis underlying his plea and the specific question at issue here: whether on June 30, 2001, [the taxpayer] willfully failed to submit a Form TD F 90-22.1 for tax year 2000."

Trial and post-trial briefs. The case thus advanced to trial. In its post-trial briefs, the government recognized that "willfulness" is rarely demonstrated with direct evidence since it involves the taxpayer's state of mind. Therefore, the government pointed toward the taxpayer's overall course of conduct, focusing on his guilty plea to tax evasion and conspiracy to defraud, his actions to conceal the unreported income, and his willful ignorance, i.e., his "conscious effort to avoid learning about reporting requirements."

Counsel for the taxpayer countered by arguing here, as he had in other briefs, that:

> (1) The taxpayer did not "willfully" fail to file the FBAR for 2000,
> (2) The government waived its right to assert the FBAR penalty when it took control of the Swiss accounts by having them frozen before the reporting deadline of 6/30/01,
> (3) The government abused its administrative discretion in asserting the maximum FBAR penalty of $100,000 per account when congressional reports confirmed that thousands of other taxpayers in similar situations had received little to no penalties, and
> (4) Even if penalties were appropriate, only one account (divided into sub-accounts for administrative purposes) instead of two accounts existed, thereby cutting the penalty in half.

The taxpayer did not act "willfully." In September 2010, the district court issued its opinion in favor of the taxpayer, basing its determination on two principal factors.

The court first indicated that the government did not adequately differentiate between simply failing and "willfully failing" to disclose an interest in foreign accounts. In this regard, the court explained that, after examining all the surrounding facts and circumstances presented during the trial process, it was not persuaded that the taxpayer was lying about his ignorance of the law and the contents of his tax return. The court acknowledged that the box on Schedule B of the taxpayer's Form 1040 for 2000 was checked "no" in response to the foreign-account question, and further understood that the taxpayer did not initially file an FBAR for 2000. The court underscored, however, that both of these actions (or inactions) occurred *after* the taxpayer discovered that the Swiss and U.S. authorities knew about the ALQI accounts.

Indeed, the FBAR filing deadline for accounts existing in 2000 (i.e., 6/30/01) was approximately eight months after the taxpayer's interview with the Swiss authorities and the resulting freezing of the accounts. According to the court, these "strongly indicate to the Court that [the taxpayer] lacked any motivation to willfully conceal the accounts from authorities after that point." The court also noted that subsequent disclosures by the taxpayer, through his representatives, corroborated his lack of willfulness with respect to 2000. In particular, the court identified the disclosures made by the taxpayer's attorneys in their meeting with the IRS in January 2002 and the revelations made in the course of applying for the OVCI in February 2003. These disclosures, noted the court, indicate the taxpayer's "consciousness of guilt for evading income taxes, which he never equated with the foreign banking disclosure."

Consistent with its earlier comments in rejecting the government's MSJ, the court next stressed that a guilty plea to *certain* charges in a previous criminal trial does not necessarily support *all* civil penalties in a subsequent matter. On this score, the court held as follows:

"The Government argues that Williams' guilty plea should estop him from arguing that he did not willfully violate §5314 for the tax year 2000. However, the evidence introduced at trial established that the scope of the facts established by Williams' 2003 guilty plea are not as broad as the Government suggests, and there remains a factual incongruence between those facts necessary to his guilty plea to tax evasion and those establishing a willful violation of §5314. That Williams intentionally failed to report income in an effort to evade income taxes is a separate matter from whether Williams specifically failed to comply with disclosure requirements contained in §5314 applicable to the ALQI accounts for the year 2000. As Williams put it in his testimony at trial, ‘I was prosecuted for failing to disclose income. To the best of my knowledge I wasn't prosecuted for failing to check that box.'"

WHY *WILLIAMS II* IS NOTEWORTHY

In this modern world characterized by "breaking" news and ever-shorter attention spans, the importance of a particular case is often lost. It is critical, therefore, to dig a little deeper in analyzing a case like *Williams II.* Doing so, one will discover that this recent case is noteworthy for a number of reasons, some more readily apparent than others.

First, in rendering its decision, the district court noted that the case was one of first impression regarding the proper legal standard to be applied in reviewing FBAR penalty cases. The statute under which the government initiated the collection suit, 31 U.S.C. section 5321(b), permits the government to commence any action to recover FBAR penalties that already have been assessed. The court observed that this provision is silent as to the relevant legal standard in such actions. Forging new ground, the court held that the *de novo* standard applies, such that the government must prove its case by a preponderance of the evidence on the record established at trial. The court indicated that the *de novo* standard is particularly appropriate here, given that the provision authorizing the civil FBAR penalty, section 5321, "provides for no adjudicatory hearing before an FBAR penalty is assessed."

Second, Williams II shows that actions to collect the FBAR penalty asserted by the IRS do not lend themselves to early resolution on brief. In rejecting the government's MSJ, the court emphasized that the question of whether the taxpayer "willfully" failed to file an FBAR for a certain year is an "inherently factual question," which generally needs to be developed through the trial process.

Third, the taxpayer's success in *Williams II* could inspire other taxpayers to reevaluate their decision to continue participating in the Service's most recent voluntary disclosure program, whose application period ran from March 2009 to October 2009. Generally speaking, those participating in the disclosure program must file Forms 1040X for the last six years, pay the back taxes, interest charges and a 20% accuracy penalty with respect to the Forms 1040X, file all appropriate information returns—including FBARs—for the last six years, and pay a "catch all" or "miscellaneous" penalty equal to 20% of the highest aggregate balance in the unreported foreign accounts during the six-year period.

The IRS released a series of frequently asked questions (FAQs) to clarify common issues related to the disclosure program. FAQ-34 addresses the options available to taxpayers who are displeased with the proposed penalties by the IRS, including the potentially enormous FBAR-related penalty. It provides the following guidance:

"If any part of the penalty structure is unacceptable to a taxpayer, that case will follow the standard audit process. All relevant years and issues will be subject to a complete examination. At the conclusion of the examination, all applicable penalties (including information return and FBAR penalties) will be imposed. Those penalties could be substantially greater than the 20 percent penalty. If the case is unagreed, the taxpayer will have recourse to Appeals."

The taxpayer's victory in *Williams II* could help some taxpayers currently engaged in the disclosure process to muster the courage to step out and roll the dice with the Service's Examination division and Appeals Office. According to a recent article, a possible result of the case is that "some taxpayers will be encouraged to opt out of the voluntary disclosure initiative and take their chances with the normal FBAR penalty regime." [28]

Fourth, although not unduly highlighted in the case, *Williams II* evidences the importance of appreciating differing assessment periods. As explained above, the IRS conducted a civil audit and proposed adjustments to income and various civil penalties with respect to 1993 through 2000, including FBAR penalties. In the case of false or fraudulent tax returns and situations involving tax evasion, the Service faces no time constraints on assessment. [29] Where FBAR violations are concerned, however, the IRS must assess the penalty within six years of the violation. [30] Accordingly, while the taxpayer in *Williams II* might have "admitted" his noncompliance by filing delinquent FBARs for 1993 through 2000 with the revenue agent in 2007, the IRS was able to assert an FBAR penalty for only one year—2000—because the six-year statute had already expired for the preceding years.

Fifth, the court chose not to address an argument of questionable strength. The taxpayer raised numerous defenses, among them the fact that he could not have violated his FBAR filing duty for 2000 because, as of the deadline for filing such return (i.e., 6/30/01), the taxpayer had no financial interest in or authority over the Swiss accounts as a result of the local authorities' freezing the funds pursuant to a request by the U.S. government. [31] This position seems strained, given that the IRS instructions for the FBAR form in effect for 2000 indicate that an FBAR must be filed if the person has the requisite interest or authority "at any time during the calendar year." [32]

The government never appeared to identify this rule, and the court declined to address it on the following basis: "Williams does dispute whether he had 'signatory or other authority' over the account due to its freezing by Swiss authorities, but the issue is rendered moot by the Court's conclusions in the remainder of this Opinion." Judicial analysis of this issue in future cases should prove interesting.

Sixth, given its decision that the taxpayer did not act "willfully," the court also did not need to resolve another issue that many others will surely face: Just how many unreported foreign accounts did the taxpayer have? The taxpayer in *Williams II* argued that, even if he were subject to an FBAR penalty, the maximum amount would be $100,000, because he only had "a single banking relationship" with the Swiss institution, not two punishable accounts, as the IRS claimed. The taxpayer tried to minimize the potential penalty amount by contending that he had only one relationship with the bank and that the bank, solely for administrative reasons, established two sub-accounts, placing equities in one, and cash in the other. In support of this theory, the taxpayer cited a bank document called "General Conditions," minutes from a meeting of the ALQI board of directors, and an ALQI corporate resolution, each of which expressly mentions one account. Foreign institutions commonly create numerous sub-accounts; therefore, this unaddressed issue will surely gain attention in future cases.

Seventh, the "reasonable reliance on a qualified tax professional" defense was unique in *Williams II.* The government presented evidence that the taxpayer never provided any information whatsoever about the foreign accounts or foreign source income to his accountant from 1993 through 2000. The government also demonstrated that the accountant sent the taxpayer an organizer each year, which specifically asked whether he had an interest in or authority over a foreign account during the year. The taxpayer, or perhaps his spouse, completed the organizer for 2000, affirmatively checking the "no" box to the foreign-account inquiry. [33] Distancing himself from this reality, the taxpayer focused on the fact that he hired U.S. tax attorneys with a reputable national firm in early June 2001, and they failed to advise him to file an FBAR before 6/30/01. The court did not address the reliance issue in its ruling, centering the discussion instead on the taxpayer's post-2001 disclosure efforts and the distinction between not reporting income and not reporting the foreign accounts in which such income was held. Future cases are likely to shed more light on the reasonable-reliance defense in the FBAR context.

Eighth, Williams II gives a glimpse into the interaction and complications between the IRS (in asserting the FBAR penalty, and then handling any Tax Court litigation related to the tax deficiencies and penalties under the Internal Revenue Code) and the Justice Department (in spearheading the collection actions in district court to recover FBAR penalties under Title 31 of the U.S. Code). Before the Tax Court in *Williams I,* the IRS attorney apparently stipulated to the fact that the taxpayer's meeting with Swiss authorities, followed by the freezing of his accounts, occurred in November 2000, i.e., approximately seven months *before* the deadline for filing the FBAR for 2000. The taxpayer later stated (mistakenly) at trial in the Tax Court that such actions occurred in November 2001.

The Justice Department tried to capitalize on that statement by suggesting that the taxpayer could not have thought that the U.S. government already had information about his accounts as of the 6/30/01 filing deadline for the FBAR. In doing so, the Justice Department attorney tried to distance himself from his IRS brethren: "The United States concedes that IRS counsel in Williams' Tax Court case entered into a stipulation that this meeting occurred on November 14, 2000.... As neither the U.S. Department of Justice, nor undersigned counsel, were involved in the Tax Court proceeding in any way, the United States should not be bound by any stipulations agreed to in that matter." [34]

While the district court in *Williams II* ultimately determined the meeting and the account-levy occurred in late 2000, it expressly noted the attempt by the Justice Department to disavow deals made by other government attorneys in a different jurisdiction. Issues triggered by this overlap in duties between the two tax enforcers—the IRS and the Tax Division of the Justice Department—may arise in other cases, too.

Ninth, the scope of FBAR "collection actions" was examined and clarified in *Williams II.* The parties had divergent opinions on the role of the district court. The government argued that the *amount* of the FBAR penalty asserted by the IRS was not subject to judicial review, and that there was no authority for the proposition that a district court, hearing a "collection action" under 31 U.S.C. section 5321(b)(2), can review the Service's administrative record or the factors considered by the IRS in determining the penalty amount.

As summarized by the government on brief, "[a]s this case simply concerns the United States' effort to collect a debt, the Court's review is limited to determining whether or not the FBAR penalty is a valid debt." [35] In other words, the government maintained that the district court's sole job was to determine, on a *de novo* basis, whether a taxpayer "willfully" failed to file the FBAR.

The taxpayer, on the other hand, repeatedly argued that the court had authority under the Administrative Procedures Act to review decisions by administrative agencies, such as the IRS, for abuse of discretion and with respect to arbitrary and capricious actions. The taxpayer further suggested that, if the court were to hold that he acted willfully, it should schedule a separate briefing to address the proper amount of the penalty. [36]

Given that the court ruled that the taxpayer did not "willfully" fail to file the FBAR and no penalties were thus sustained, this issue was not specifically addressed in the *Williams II* opinion. Nevertheless, it remains important for a few reasons. Since the Service was delegated the authority to assert FBAR penalties several years ago, it has always had discretion about whether a particular taxpayer should be penalized, as the relevant provision expressly states that the IRS "may" (not "shall" or "must") assert an FBAR penalty in certain cases. [37]

The Service's discretion has expanded in recent years, covering both the existence and amount of the penalty. The relevant provision in effect in 2000 only penalized "willful" violations, and the penalty amount was the larger of $25,000 or the highest balance in the unreported account (not to exceed $100,000). [38] Under the AJCA, which took effect in October 2004, the IRS may use its discretion in determining the penalty amount in cases of non-willful violations.

Lest there be any doubt in this regard, the Service's own Manual outlines the following parameters for its agents: "Examiners are expected to exercise discretion, taking into account the facts and circumstances of each case, in determining whether penalties should be asserted and the total amount of penalties to be asserted." [39] This requires the IRS to decide whether the FBAR violation was attributable to "reasonable cause," which lends itself to judicial review. [40]

Finally, Williams II is noteworthy for the inevitable controversy it will engender with respect to its breadth. Practitioners and taxpayers may argue that the case constitutes generalized precedent for the concept that checking the "no" box on Schedule B to Form 1040 is different from failing to file an FBAR, that relying on tax professionals can demonstrate a lack of willfulness, and that making a "noisy" disclosure to the IRS—even after being caught with an unreported foreign account—can be construed as further evidence of non-willfulness. [41] The government, by contrast, probably will adopt a narrower reading of the case, suggesting that it would apply only where a taxpayer neglects to disclose "already-frozen assets in a foreign account."

CONCLUSION

Now that the most recent IRS voluntary disclosure program has closed, the government is intensifying its efforts to penalize, criminally and/or civilly, taxpayers engaged in offshore noncompliance. Consequently, the issues addressed in *Williams II,* particularly the unresolved FBAR items, will arise in future cases. When they do, many taxpayers and practitioners will be watching to see how the open FBAR questions evolve.

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See generally Weinstein and Packman, "FBAR—Foreign Bank Account Reporting Obligations: A Primer for the Practitioner," 106 JTAX 44 (January 2007).

2

Treasury Department, *A Report to Congress in Accordance with §361(b) of the USA PATRIOT Act* (4/26/02), pages 9-10.

3

See generally Packman, "Noncompliance After the IRS Offshore Income Reporting Initiative—What Options Remain?," 111 JTAX 281 (November 2009), and the Baker & McKenzie Voluntary Disclosure Steering Committee, "Experiences With the 'New' Voluntary Disclosure Program—Some Good, Some Bad," 113 JTAX 46 (July 2010).

4

See Sardar, "What Constitutes 'Willfulness' for Purposes of the FBAR Failure-to-File Penalty?," 113 JTAX 183 (September 2010).

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P.L. 91-508, 10/26/70, Title I and Title II.

6

Id., section 202.

7

See also 31 C.F.R. section 103.24.

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

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Id.; 31 C.F.R. section 103.56(g).
10

31 U.S.C. section 5321(a)(5)(A) (as in effect before 10/23/04).
11

The courts have consistently held that "willfulness" means a "voluntary, intentional violation of a known legal duty." Cheek, 67 AFTR 2d 91-344, 498 US 192, 112 L Ed 2d 617, 1991-1 CB 259 (1991); U.S. v. Sturman, 951 F2d 1466 (CA-6, 1991); Bishop, 32 AFTR 2d 73-5018, 412 US 346, 36 L Ed 2d 941, 1973-2 CB 417 (1973).
12

31 U.S.C. sections 5321(a)(5)(B)(i) and (ii) (as in effect before 10/23/04).
13

31 U.S.C. section 5321(a)(5)(A) (as in effect after 10/22/04).
14

Id., section 5321(a)(5)(B)(i) (as in effect after 10/22/04).
15

Id., section 5321(a)(5)(B)(ii) (as in effect after 10/22/04). The second condition means that the taxpayer agrees to file delinquent FBARs with the revenue agent as part of the audit. I.R.M. 4.26.16.4.4 (7/1/08).
16

Id., sections 5321(a)(5)(C)(i) and (5)(D)(ii) (as in effect after 10/22/04).
17

The facts and rulings were derived from various court documents in Williams II, including Complaint filed 4/23/09, Answer filed 7/10/09, the government's Motion for Summary Judgment (MSJ) and Memorandum in Support filed 1/6/10, Defendant's Opposition to Government's MSJ filed 1/29/10, the government's Reply Brief to Defendant's Opposition to MSJ filed 2/10/10, Hearing held on 3/12/10 regarding MSJ, Court Order issued 3/19/10 regarding MSJ, Defendant's Proposed Findings of Fact and Conclusions of Law filed 4/25/10, the government's Proposed Findings of Fact and Conclusions of Law dated 4/26/10, Defendant's Post-Trial Brief filed 7/1/10, the government's Post-Trial Brief filed 7/1/10, Defendant's Response to Government's Post-Trial Brief filed 7/15/10, the government's Reply to Defendant's Post-Trial Brief filed 7/15/10, the decision by the district court issued 9/1/10. All of these documents are on file with the author. Certain facts were also derived from the Tax Court's Williams I opinion, and also from Williams, TC Memo 2009-81, RIA TC Memo ¶2009-081 .
18

Rev. Proc. 2003-11, 2003-1 CB 311, section 1.
19

Id., section 2.
20

Id., section 4.
21

The motion raised other issues that are beyond the scope of this article.
22

Section 6330(a).
23

Sections 6330(a) through (c).
24

Section 6330(c)(3)(C); see also H. Rep't No. 105-599, 105th Cong., 2d Sess. 263 (1998).
25

Section 6330(d); Tax Court Rule 331(b). This petition is called a "Petition for Lien or Levy Action Under Section 6320(c) or 6330(d)."

26

Sections 6301, 6230, 6231, 6330, 6331, and 6665.

27

The Tax Court later issued an opinion granting the Service's motion for partial summary judgment on the question of whether the taxpayer, as a result of his earlier guilty plea to criminal fraud, was collaterally estopped from disputing civil fraud in the subsequent civil tax case (TC Memo 2009-81, RIA TC Memo ¶2009-081). A trial was then held before the Tax Court on 9/28/09 regarding the proposed tax deficiencies and accuracy-related penalties; a decision has yet to be rendered.

28

Coder, "U.S. Government Position on FBAR Penalties Called into Question," 2010 Worldwide Tax Daily 174-4 (9/9/10).

29

Sections 6501(c)(1) and (2).

30

31 U.S.C. section 5321(b)(1).

31

Defendant's Post-Trial Brief filed 7/1/10.

32

Form TD F 90-22.1 (Rev. 7/00), Instructions—General Instructions.

33

Government's Proposed Findings of Fact and Conclusions of Law filed 4/26/10; government's Post-Trial Brief filed 7/1/10, page 10.

34

Government's Post-Trial Brief filed 7/1/10, page 16, fn. 5.

35

Id., page 14.

36

Defendant's Response to Government's Post-Trial Brief, filed 7/15/10, pages 8-10.

37

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

38

31 U.S.C. section 5321(a)(5) (in effect before 10/23/04).

39

I.R.M. 4.26.16.4 (7/1/07).

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Note 38, *supra.* See, e.g., Kansas City Southern Industries, Inc., 98 TC 242 (1992) (holding that "[i]n this case, as in others, the remedy for abuse of discretion is to disregard the consequences of the Commissioner's action or refusal to act, not to order the Commissioner to perform the act").

41

Coder, *supra* note 28.