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The FBAR penalty [is] [is not] a fine. Choose one.

October 1, 2024

Conflicting Decisions: In August, the U.S. Court of Appeals for the Eleventh Circuit held in *United States v. Schwarzbaum*[1] that a monetary civil penalty imposed for willfully failing to file a foreign bank account report ("FBAR") was a "fine," and had to be evaluated for excessiveness under the Excessive Fines Clause of the Eighth Amendment. The Eleventh Circuit held that the penalty was a fine because it did not have a "remedial" purpose that compensated the United States for expenses or loss.

Two years earlier, the First Circuit in *United States v. Toth*[2] held that a monetary civil penalty imposed for willfully failing to file an FBAR report was *not* a "fine" and did not have to be evaluated for excessiveness under the Excessive Fines Clause of Eighth Amendment. The First Circuit concluded that the FBAR penalty was damages and not a fine by focusing on the culpability of the party before it. The First Circuit instead found that the FBAR penalty generally compensated the United States for the cost of all its investigatory efforts to find unreported foreign bank accounts. The Supreme Court denied certiorari in *Toth* over a dissent by Justice Neil Gorsuch.

Final resolution of the issue will require action by Congress or the Supreme Court.

FBAR Law: Each American citizen with interests in or authority over any foreign bank account with a balance exceeding $10,000 must file an annual FBAR with the IRS identifying and describing that account.[3] The maximum civil penalty for willfully violating the FBAR reporting requirement is the greater of (i) $100,000 or (ii) 50% of the balance in the account at the time of the violation.[4] The penalty applies to each annual failure to file the FBAR even if the same account is not reported for a number of years.

Eighth Amendment: The Eighth Amendment to the United States Constitution prohibits imposing "excessive fines."[5]

Supreme Court Jurisprudence: In *Austin v. United States*,[6] the Supreme court ruled, after reviewing English law, that "the purpose of the Eighth Amendment … was to limit the government's power to punish." It added that a civil penalty is subject to the Eighth Amendment because it may constitute punishment even though the court imposing the penalty is civil rather than criminal, and even though the penalty serves both remedial and punitive purposes.

Five years later the Supreme Court, in *United States v. Bajakajian*, again held that the purpose of the Eighth Amendment was intended to limited punishment of the wrongdoer.[7]

Facts: In the Eleventh Circuit case, Mr. Schwarzbaum, a naturalized United States citizen, acquired a foreign bank account from his father, a Swiss national, with a balance of $16,000 for which he did not file an FBAR. The Internal Revenue Service, which administers FBAR, found that he recklessly ignored his reporting responsibility for a three-year period for the $16,000 account and fined him $100,000 per year for each of the three years, for a total of $300,000.[8]

In the First Circuit case, Ms. Toth, a naturalized United States citizen, acquired a foreign bank account from her father with a balance of $4.3 million, for which she willfully did not file an FBAR report. The IRS assessed a civil penalty against Ms. Toth for half the value of her account plus another million dollars for late fees and interest.[9]

The Eleventh Circuit's Reasons for Treating the FBAR Penalty as a Fine: The purpose of the FBAR penalty is punishment. It has its origin in English law which prohibited an excessive fine for an offense.[10]

The FBAR penalty is calculated without regard to the magnitude of the financial injury, thus precluding it from being characterized as remedial. Moreover, even if the penalty is simultaneously punitive and remedial, the punitive feature subjects the penalty to analysis under the Eighth Amendment. To sustain a penalty without regard to the Eighth Amendment, the IRS must show that penalty is solely remedial in that it specifically reflects the damages that the government suffered. Otherwise, it is treated as a deterrent and retributive—in other words—punitive.

A penalty is excessive under the Eighth Amendment if it is grossly disproportionate to the gravity of the offense—in the case of Mr. Schwarzbaum the offense was concealing a foreign account with a balance of $16,000. Three factors measuring disproportionality are (i) whether the defendant is in the class of persons at whom the statute was principally directed; (ii) how the imposed penalties compare to other penalties authorized by the legislature; and (iii) the harm caused by the defendant. Applying these factors, a $100,000 fine for each of the years for not disclosing the $16,000 account was grossly disproportional.

The First Circuit's Reasons for Treating the FBAR Penalty as a Fine: The Eighth Amendment encompasses monetary penalties—whether civil or criminal—that are punishment for an offense. But in *Austin* and *Bajakajian*, the Supreme Court required a criminal proceeding as a predicate for the civil penalty to be characterized as punishment.[11] Ms. Toth was not criminally prosecuted for failing to report her foreign bank account. The penalty merely followed an IRS audit, which is an administrative proceeding. There was no criminal predicate to the FBAR penalty, and consequently it was not a fine.

The government loses hundreds of millions of dollars because of taxpayer concealment of foreign bank accounts. The FBAR penalty is liquidated damages that compensates the United States for the cost to investigate all these concealments.

Moreover, it is like a civil tax penalty that is not punishment within the meaning of the Double Jeopardy Clause—criminal prosecution for the same crime twice—because a taxpayer can be criminally prosecuted for a tax crime and still be liable for the civil fraud tax penalty without being subjected to double jeopardy. [12]

Petition for Writ of Certiorari: Ms. Toth petitioned the Supreme Court for a writ of certiorari. The Court denied the petition, but Justice Gorsuch dissented from the denial and appended a statement, writing that the Eighth Amendment is derived from English law and has its support in history and tradition of the United States, which would mean little if Congress could append a "civil" label to a penalty and thereby avoid constitutional scrutiny.[13]

He chastised the government for making no effort to prove that the penalty was remedial because the government introduced no evidence concerning its cost to investigate Ms. Toth. Justice Gorsuch summed up his statement with the interesting thought that the phrase "nonpunitive penalties" was simply a contradiction in terms.

Comment: Only the First and Eleventh Circuits have opined on the application of the Eighth Amendment to the FBAR penalty.[14]

Continued

Please contact your Miller Canfield attorney or an author of the alert if you would like to discuss these developments.

[1] --- F.4th ---, 2024 WL 3997326 (11th Cir. No. 22-14058 Aug. 30, 2024).

[2] 33 F.4th 1 (1st Cir. 2022), cert. denied, ____ U.S. ____, 143 S. Ct. 552 (2023).

[3] 31 C.F.R. §1010.306(c)("Reports required to be filed by § 1010.350 shall be filed with FinCEN on or before June 30 of each calendar year with respect to foreign financial accounts exceeding $10,000 maintained during the previous calendar year"); §1010.350(a)(" Each United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country shall report such relationship to the Commissioner of Internal Revenue for each year in which such relationship exists ….")

[4] 31 U.S.C. §5321(a)(5)(C)(i), (D)(ii).

[5] U.S. Const. amend. VIII.

[6] 509 U.S. 602 (1993).

[7]524 U.S. 321 (1998).

[8] Mr. Schwarzbaum had acquired a number of foreign bank accounts, and after getting bad advice from his CPA and trying himself to understand the reporting requirement, he did not report these accounts, which resulted in penalties in the millions.

[9] Ms. Toth was in her eighties and apparently thought that if she ignored the proceedings, they would disappear. Finally, at the court's insistence, she retained counsel.

[10] The court reached back to the Charter of Liberties of Henry I, adopted in 1101, which stated that "[i]f any of my barons or men shall have committed an offence he shall not give security to the extent of forfeiture of his money, as he did in the time of my father, or of my brother, but according to the measure of the offence so shall he pay. . . ." Thus, there was an indication that prohibiting an excessive fine related to the commission of an "offence" and for which the punishment must be appropriate and proportional. The next historical stop was the Magna Carta to which the king agreed in 1215, and which provided that "A free man shall be amerced [punished by fine] for a small fault only according to the measure thereof, and for a great crime according to its magnitude…." Again, the terms "amerced" and "crime" indicate that a fine related to punishment and not compensatory damages, and again the fine had to be proportional. The Eleventh Circuit's historical review of English law concluded with the English Bill of Rights of 1689, which the court said was a "codification" of the foregoing 1101 charter and 1215 the agreement. The founders then borrowed from the English Bill of Rights for the text of the Eighth Amendment.

[11] The defendant in *Austin* was a drug dealer who was prosecuted for his illegal activities. Thereafter, the government pursued a civil forfeiture of his property – his mobile home and automotive repair shop equipment—where the crime occurred. The defendant in *Bajakajian* was prosecuted for not reporting to a customs officer than he was removing $357,000 in cash from the United States. Thereafter, the government sought civil forfeiture of all the cash. In both cases, the Supreme Court ruled that the Eighth Amendment applied and had to be evaluated for excessiveness.

[12] *Helvering v. Mitchell*, 303 U.S. 391, 398 (1938).

[13] 143 S. Ct. 552.

[14] The Tax Court has no jurisdiction to review a Treasury Department imposition of an FBAR penalty because the penalty does not result from a notice of deficiency issued by the Internal Revenue Commissioner.