



## International Tax ADVISORY ■

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### Back to School: FBAR Penalties and a Lesson in Statutory Construction

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Every U.S. person who has a financial interest in, or signature authority over, any foreign financial accounts (including bank accounts, securities, or other types of financial accounts located outside of the U.S.) must file a report on FinCEN 114 (commonly referred to as FBAR) if the aggregate value of the foreign financial accounts exceeds \$10,000 at any time during the calendar year.

The civil and criminal penalties for noncompliance with the FBAR filing requirements can be significant. The current statute, 31 U.S.C. § 5321(a)(5), provides that the Treasury may impose civil penalties for FBAR violations: civil penalties for a non-willful violation can range up to \$10,000 per violation, and civil penalties for a willful violation can range up to the greater of \$100,000 or 50% of the amount in the account at the time of the violation. These penalties are adjusted for inflation. The amounts in the current statute reflect a 2004 amendment, which increased the maximum civil penalties that can be assessed for a willful violation. In the prior statute, the maximum penalty was \$100,000. The current regulation, 31 C.F.R. § 1010.820(g), was based on the language of the prior statute and provides that in the case of a willful violation, the Treasury may assess a penalty of \$25,000 or up to the balance of the account, but no greater than \$100,000.

As one would expect, given that the regulation was never updated to reflect the 2004 amendment to the statute, there is much confusion and disagreement among taxpayers and the IRS about the maximum penalty for a willful violation of the FBAR filing requirements.

Since May, three reported cases have dealt with the issue of whether the IRS can impose a penalty greater than \$100,000 for a willful violation of the FBAR filing requirements.

In the first case, *United States v. Colliot*, No. 16-cv-01281 (W.D. Tex. May 16, 2018), the IRS assessed penalties far exceeding \$100,000 for several willful violations of the FBAR filing requirements by the taxpayer. The taxpayer argued that the IRS acted arbitrarily and capriciously by assessing penalties exceeding the \$100,000 maximum provided for in the regulation, and sought dismissal of the case. The IRS, however, argued that the regulation containing the \$100,000 limit is inconsistent with the current statute and thus the regulation has been implicitly superseded or invalidated.

The Western District of Texas was not persuaded by the IRS's argument. The court held that, despite the 2004 amendment to the statute that authorized higher penalties, the IRS could not impose penalties exceeding the amounts provided for

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in the regulation. The court reasoned that the 2004 amendment created a penalty ceiling, and the Treasury has discretion to determine the appropriate penalty within that limit.

Just two months after the *Colliot* decision, the IRS was dealt another blow in *United States v. Wadhan*, No. 17-cv-01287 (D. Colo. July 18, 2018). In *Wadhan*, the taxpayers failed to file or filed inaccurate FBARs for several years. In response, the IRS assessed penalties equaling 50% of the account balances for each year at issue, which far exceeded \$100,000. The taxpayers argued that the assessments were improper because the IRS only had the authority as limited by the \$100,000 cap in the regulation. The IRS argued that it was obligated to impose the penalties in the statute, that the statute does not reflect any discretion to impose penalties smaller than the full amount authorized by Congress, and that the 2004 amendment to the statute supersedes any regulatory inconsistency.

Just like the court in *Colliot*, the District of Colorado found the taxpayers' argument more persuasive than the IRS's arguments. The court found that both the prior version of the statute and the current statute specifically grant the Treasury Secretary discretion to assess penalties, and no legislative history presented by the IRS suggested otherwise. Additionally, the court stated that in order for the statute to supersede the regulation, the statute must be clearly inconsistent with the regulation. The court did not agree with the IRS that the current statute is clearly inconsistent with the regulation. Notably, the court stated that although the penalty caps in the statute and the regulation differ, one cannot assume that the Treasury Secretary simply overlooked the difference since that difference has existed since 2004. In conclusion, the court stated: "Although the IRS believes that it is empowered by 31 U.S.C. § 5321 to act, it is not. It is empowered by the Secretary who has discretion to determine what penalties are imposed. § 1010.820 remains in effect until amended or repealed."

Following the *Colliot* decision in May and the *Wadhan* decision in mid-July, it seemed like a safe bet that the IRS was unlikely to prevail on this issue. Few would have guessed that just two weeks after the *Wadhan* decision, the IRS's luck would change. To the surprise of many, in *Norman v. United States*, No. 1:15-cv-00872 (Court of Federal Claims July 31, 2018), the court's decision came out in favor of the IRS. In *Norman*, the taxpayer failed to file an FBAR for her Swiss account. The IRS determined that her failure was willful, and it assessed a penalty equal to 50% of the Swiss account balance, amounting to far more than \$100,000. The taxpayer argued that the court should follow the holding in *Colliot* and cap the penalty at \$100,000.

The Court of Claims declined to follow the holding in *Colliot*. The court found the language of the statute to be unambiguous, supported by its view that Congress intended to increase the penalties for willful violations of the filing requirements. It observed that, while the *Colliot* court relied on the general language of the statute vesting the Treasury with discretion to determine FBAR penalties, it ignored the specific 2004 mandate of the statute that, in the case of willfulness, the penalty "shall" be increased to the greater of \$100,000 or 50% of the account balance. The court found that the 2004 amendment did not merely allow for a higher ceiling on penalties. Rather, through the 2004 amendment, Congress raised the new ceiling itself, and in so doing, removed the Treasury Secretary's discretion to regulate any other maximum. Thus, the court held that the statute superseded the regulation in this particular case.

The court's decision in *Norman* was surely a welcome win for the IRS. However, this issue is far from settled now that there is a split at the trial court level. This issue is pending before several other district courts, and it is anticipated that the issue will go up to the circuit courts, and possibly even the Supreme Court. It is not clear how the statute will eventually be interpreted on appeal, but taxpayers will be watching this area very closely.

For more information, please contact [Edward Tanenbaum](#) at 212.210.9425 or [Stefanie Kavanagh](#) at 202.239.3914.

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