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International Tax ADVISORY ■

JUNE 15, 2014

Taxpayer Settles for Less than 150 Percent FBAR Penalty after Jury Found Willful Failure to File

On May 29, 2014, the U.S. Department of Justice (DOJ) announced that a district court jury in southern Florida had found that a U.S. citizen willfully failed to file required Reports of Foreign Bank and Financial Accounts (FBARs) for three years. Because the maximum civil penalty for willful failure to file can equal up to 50 percent of the account value *for each year* the FBAR was not filed, the taxpayer potentially faced penalties equal to 1.5 times the value of the account. The case *United States v. Zwerner* raised important questions not only about the FBAR penalties at issue, including their constitutionality, but also about the IRS' administration of the Offshore Voluntary Disclosure Program (OVDP). The parties reached a settlement on the amount of penalties earlier this month.

Background

Under the Bank Secrecy Act, U.S. persons that have a financial interest in or signature authority over foreign financial accounts with an aggregate value of $10,000 or more at any time during the calendar year generally must file an FBAR to report the accounts. The FBAR is due by June 30 of the following year. (Taxpayers are also required to note interests in foreign accounts on Schedule B of their tax return, as well as on Form 8938, in many cases.) The Financial Crimes Enforcement Network (FinCEN), an agency of the U.S. Treasury, administers the Bank Secrecy Act, though civil enforcement was delegated to the IRS in 2003.

Zwerner opened a bank account in Switzerland in the 1960s. Though the account was nominally held by two foundations he created (on advice of the bank), Zwerner essentially treated the account as his own personal account. For the tax years in issue, 2004 through 2007, Zwerner did not report the account or any income from it on his original tax returns or file FBARs, though the account balance in each year exceeded $1.4 million. The government noted that Zwerner had answered "no" to questions from his accountants, who asked whether he had an interest in a foreign financial account and whether he had foreign income or paid foreign taxes.

The government alleged that Zwerner had a reportable financial interest in the account (as beneficial owner), which he did not disclose until he filed a late FBAR in October 2008 for the 2007 year. (Zwerner later filed amended returns and delinquent FBARs for 2004 through 2006 in March 2009.) Further, the government claimed his failure to file was willful, seeking the maximum civil penalty of 50 percent of the account value in each year, which in aggregate, could have amounted to twice the account's total value.

At trial, the jury was asked to decide whether Zwerner was liable for FBAR penalties for the years at issue. The jury found that Zwerner's failure to file FBARs was willful, but only for the years 2004 through 2006. (The jury found that the taxpayer's failure to file for 2007 was not willful.) The parties reached a settlement, whereby Zwerner will pay the 50-percent penalties for 2004 and 2005, but not 2006—i.e., the FBAR penalty is approximately 100 percent of the account value. Interest and statutory penalties will also apply.

Import for Voluntary Disclosures and FBAR Penalties

The *Zwerner* case raises interesting questions, of particular importance in the anti-international tax evasion landscape, whose looming focal point is FATCA, a statute aimed at detecting people who have used offshore accounts to escape U.S. tax obligations. Though the jury's decision represents a win for the government, some aspects of Zwerner's challenge could hold bright contours for taxpayers.

Zwerner argued that he had intended to make and believed he had made (and should be treated as having made) a voluntary disclosure to the IRS in early 2009 before any audit or criminal investigation commenced, a move which should preclude his exposure to *multiple* FBAR penalties. Zwerner proffered the following as support: (i) a procedure in Rev. Proc. 2003-11, 2003-1 C.B. 311, a predecessor to the "modern" OVDP, whereby a taxpayer could make a voluntary disclosure and not be subject to civil fraud penalties under Section 6653; (ii) the "capped penalty" OVDPs of 2009 (maximum 20-percent penalty), 2011 (25 percent) and 2012 (27.5 percent); and (iii) the "consistent policy" of the DOJ not to pursue multiple 50-percent FBAR penalties, even where taxpayers are criminally convicted, as demonstrated by anecdotal reports and DOJ announcements about FBAR penalties imposed on other taxpayers.

The jury was not convinced by Zwerner's voluntary disclosure argument, specifically finding him ineligible for the IRS' formal programs. The IRS has generally enjoyed unchecked reign over its voluntary disclosure initiatives, which set forth strict requirements for eligibility, participation and penalties in dozens of FAQs. Apparently, to the IRS, taking the possibility of criminal prosecution off the table is more than gracious, and many taxpayers have agreed, flocking to the OVDPs in droves. According to those FAQs, there is no appealing the terms of an OVDP closing agreement. For those taxpayers who do find the OVDP results "too severe," they may, rather than sign a closing agreement, take their chances "opting out" of the offshore penalty structure—inviting a likely "full scope examination," though only after making a voluntary disclosure through the program. So, while the jury's finding is unfortunate for Zwerner, the fact that the jury confronted the OVDP issue at all could mean the IRS' administration of the OVDP may not be totally insulated from judicial consideration.

Zwerner also argued that the multiple FBAR penalties assessed against him violate the Eighth Amendment's prohibition on "excessive fines." For support, he relied primarily on a 1998 Supreme Court case, *United States v. Bajakajian*, 524 U.S. 321, which involved the Bank Secrecy Act provision requiring a person to report the transport U.S. currency totaling

$10,000 or more, on any one occasion, into or out of the United States. The Supreme Court held that forfeiture, permitted under the statute, of the entire amount of money transferred, more than $350,000, would constitute an unconstitutionally excessive fine for a reporting violation alone (without attendant criminal activity).

The Eighth Amendment claim is not an easy one to make. In the first instance, the IRS presumably must find the facts sufficiently "egregious" to feel substantial penalties are warranted. The taxpayer must then show that his or her case is not so terrible to justify those penalties. The Constitution's excessive fines clause asks whether a civil penalty constitutes punishment (at least in part) and, if so, whether it is "grossly disproportionate" to the violation. In cases like Zwerner's, where multiple penalties effectively constitute forfeiture and then some, taxpayers ironically may have a better position. Where the penalties are less than full forfeiture (but nonetheless substantial), taxpayers may have a harder time showing excessiveness. As usual, it will depend on the facts. Because the parties in *Zwerner* settled—albeit for the full account value during the years at issue, plus additional penalties and interest—the district court will not reach the constitutional question. Therefore, the viability of an Eighth Amendment challenge to FBAR penalties is anyone's guess. Still, *Zwerner* has raised the issue's profile.

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