What Garrity Teaches About FBARs, Foreign Trusts, "Stacking" of International Penalties, and Simultaneously Fighting the U.S. Government on Multiple Fronts

By Hale E. Sheppard*

Hale E. Sheppard examines the lessons that Garrity *teaches.*

I. Introduction

Taxpayers often misunderstand their international tax and information-reporting duties, which can trigger big problems with the IRS. Taxpayers, likewise, are frequently clueless about what fighting the IRS on an international matter really entails, which can create even bigger troubles. A recent case, *Garrity*, helps put these matters in context.[1] The case is noteworthy because it involves income taxes, estate taxes, and a variety of international penalties, it takes place in multiple venues (*i.e.*, Tax Court, District Court, and Probate Court), and it addresses two fundamental issues to taxpayers, namely, whether willful FBAR penalties are capped at $100,000 per violation, and whether the IRS is constitutionally banned from "stacking" Financial Crimes Enforcement Network ("FinCEN") Form 114 ("FBAR") penalties and information-reporting penalties stemming from the same activities. This article examines the lessons that *Garrity* teaches.

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II. Summary of International Duties

Understanding the key issues in *Garrity* first requires some basic knowledge about the relevant tax and information-reporting obligations, the potential penalties for violations, *etc*. These items are summarized below.

A. 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]

Congress was concerned about widespread non-compliance; therefore, it enacted more stringent FBAR penalty provisions in 2004 as part of the American Jobs Creation Act ("Jobs Act").[4] Under the law in existence *before* the Jobs Act, the IRS could only assert penalties where it could demonstrate that taxpayers "willfully" violated the FBAR rules.[5] If the IRS managed to satisfy this high standard, it could impose a relatively small penalty, ranging from $25,000 to $100,000, regardless of the size of the hidden accounts.[6]

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.[7] In the case of non-willful violations, the maximum penalty is $10,000.[8] The Jobs Act calls for higher 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 percent of the balance in the undisclosed account at the time of the violation, whichever amount is larger.[9] Given the multi-million dollar balances in some unreported accounts, FBAR penalties can be enormous.

B. Disclosure of Foreign Accounts, Assets, and Income

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 financial interest in, had an 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.[10]

When it comes to individuals, they have several duties, in addition to filing FBARs, linked to holding a reportable interest in a foreign financial account:

- They must check the "yes" box on Schedule B (Interest and Ordinary Dividends) to Form 1040 (*U.S. Individual Income Tax Return*) to disclose the existence of the foreign account;
- They must identify the foreign country in which the account is located, also on Schedule B to Form 1040;
- They must declare all income generated by the account (such as interest, dividends, and capital gains) on Form 1040; and
- They generally must report the account on Form 8938 (*Statement of Specified Foreign Financial Assets*), which is enclosed with Form 1040.[11]

C. Questions and Cross-References on Schedule B

One of the duties listed above is checking "yes" to the foreign-account inquiry found on 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.

D. The Significance of Signing Forms 1040

Taxpayers must sign and date their Forms 1040 in order for them to be valid. Many seem unaware that by executing Forms 1040 they are making the following broad, sworn statement to the IRS, which often comes back to haunt them in tax and penalty disputes:

> Under penalties of perjury, I declare that *I have examined this return and accompanying schedules [including Schedule B] and statements*, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year.

E. Form 3520 and Form 3520-A—Duty to Report Foreign Trusts

Taxpayers are obligated to file a Form 3520 (*Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*) and/or Form 3520-A (*Annual Information Return of Foreign Trust with a U.S. Owner*) in certain situations involving foreign trusts.

1. Form 3520

Form 3520 generally must be filed in two circumstances. First, a "responsible party" generally must file a Form 3520 within 90 days of certain "reportable events," such as the creation of any foreign trust by a U.S. person, the transfer of any money or other property (directly or indirectly or constructively) to a foreign trust by a U.S. person, and the death of a U.S. person, if the decedent was treated as the "owner" of any portion under the grantor trust rules, or if any portion of the foreign trust was included in the gross estate of the decedent.[12] Second, a U.S. person ordinarily must file a Form 3520 if he receives during a year (directly or indirectly or constructively) any distribution from a foreign trust.[13] The penalty for not filing a Form 3520 is equal to $10,000 or 35 percent of the so-called "gross reportable amount," whichever amount is larger.[14] However, the IRS will not assert penalties where there is "reasonable cause" for the violation.[15]

2. Form 3520-A

A Form 3520-A normally must be filed if, at any time during the relevant year, a U.S. person is treated as the "owner" of any portion of the foreign trust under the grantor trust rules.[16] A person, other than the grantor, is treated as the owner if he has "a power exercisable solely by himself" to vest the assets or income from the trust in himself.[17] Moreover, a U.S. person who transfers property, directly or indirectly, to a foreign trust generally shall be treated as the owner during the year of the transfer for his portion of the trust attributable to such property, if there is a U.S. beneficiary of such trust.[18] The normal penalty for Form 3520-A violations is the higher of $10,000 or five percent of the "gross reportable amount."[19] Penalties will not be asserted where there is "reasonable cause" for the violation.[20]

3. Questions About Foreign Trusts on Schedule B

As explained above, Schedule B to Form 1040 asks about the existence and location of foreign accounts. It inquires about foreign trusts, too. The language from the Schedule B for 2017 is set forth below:

> During 2017, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See instructions on back.

The IRS's Instructions to Schedule B expand on the foreign trust concept, providing the following guidance:

> If you received a distribution from a foreign trust, you must provide additional information. For this purpose, a loan of cash or marketable securities generally is considered to be a distribution. See Form 3520 for details. If you were the grantor of, or transferor to, a foreign trust that existed during 2017, you may have to file Form 3520. Don't attach Form 3520 to Form 1040. Instead, file it at the address shown in its instructions. If you were treated as the owner of a foreign trust under the grantor trust rules, you are also responsible for ensuring that the foreign trust files Form 3520-A. Form 3520-A is due on March 15, 2018, for a calendar year trust. See the instructions for Form 3520-A for more details.

III. So Many Fights on So Many Fronts

Taxpayers with undeclared foreign accounts, assets, entities and/or income often find themselves engaged in a multifaceted war against the U.S. government.

A simple example shows how this works. Assume that Scofflaw Stan held foreign accounts during 2017, with an aggregate balance of approximately $2 million, which yielded a total of $100,000 in interest income. Further assume that Scofflaw Stan did not report the foreign-source income on his 2017 Form 1040, did not disclose the existence of the foreign accounts by checking the "yes" box on Schedule B to the 2017 Form 1040, did not enclose a Form 8938 with his 2017 Form 1040, and did not electronically file an FBAR.

After conducting an audit, the IRS might issue the following items to Scofflaw Stan: (i) a Notice of Deficiency proposing increased taxes on the $100,000 of unreported income, an accuracy-related penalty, and interest charges, (ii) an FBAR 30-day letter (*i.e.*, Letter 3709) and an FBAR Agreement to Assessment and Collection (*i.e.*, Letter 13449) asserting a penalty of $1 million, which constitutes the maximum sanction of 50 percent of the highest aggregate balance of the unreported foreign accounts, and (iii) a Notice Letter (*i.e.*, Letter 4618) and/or Form 8278 (*Assessment and Abatement of Miscellaneous Civil Penalties*) asserting a penalty of $10,000 for failure to file Form 8938.[21]

If Scofflaw Stan disputes all proposed taxes and penalties, then he will become familiar with at least three different venues, as well as the costs of fighting in each. First, Scofflaw Stan would file a Petition with the Tax Court to dispute the income taxes and tax-related penalties proposed in the Notice of Deficiency.[22] As explained further below, this is what happened in *Garrity*.

Second, because the FBAR penalty derives from Title 31 of the U.S. Code (*i.e.*, Money and Finance) as opposed to Title 26 of the U.S. Code (*i.e.*, Internal Revenue Code), it cannot be challenged in Tax Court.[23] Thus, after Scofflaw Stan exhausts his administrative appeal rights with the IRS, the Department of Justice ("DOJ") will bring a collection action against him in District Court.[24] Again, this is exactly what occurred with *Garrity*.

Third, given that penalties for not filing Form 8938 are not related to a tax deficiency, the IRS takes the position that they are not challengeable in Tax Court.[25] Since the Form 8938 sanction is an "assessable" penalty, taxpayers generally find themselves challenging it in one or more of the following manners: (i) filing a Protest Letter, essentially requesting penalty abatement, in response to the first notice from the IRS; (ii) administratively challenging with the Appeals Office any negative decision by the IRS Service Center about the penalty-abatement request; (iii) filing a request for, and participating in, a Collection Due Process ("CDP") hearing with the IRS, after the IRS issues its notice threatening imminent levies of the taxpayer's property to satisfy the penalty; and (iv) seeking review of an unfavorable CDP determination in the Tax Court, paying the penalty under protest and then initiating a refund action with the IRS, or simply waiting for the DOJ to start a collection suit in District Court. A variation of this happened with *Garrity*, as the IRS assessed penalties for unfiled Forms 3520 and Forms 3520-A, instead of Forms 8938. Congress did not introduce the Form 8938 filing duty until 2011, and the years involved in *Garrity* preceded that. If the IRS were authorized to assert Form 8938 penalties in *Garrity*, one must assume that it would have done so, adding them to the long list of taxes and penalties assessed by the IRS.

IV. Relevant Facts in *Garrity*

Synthesizing multiple court documents and making some basic assumptions, the key facts in *Garrity* appear to be the following.[26]

Paul G. Garrity, Sr. ("Paul") founded Garrity Industries, Inc. ("Domestic Company") in 1967. It primarily manufactures and sells lighting products.

About two decades later, in 1989, Paul established the Lion Rock Foundation, a so-called Stiftung in Liechtenstein ("Foreign Trust"). Paul was named the primary beneficiary of the Foreign Trust from inception, and, during his lifetime, he retained the right to amend or revoke the governing documents. Paul entered into an agreement with BIL Treuhand AG ("Foreign Trustee"), whereby it would appoint the Board of Directors for the Foreign Trust. The agreement with the Foreign Trustee expressly mandated that all members of the Board of Directors act in accordance with instructions from Paul or anyone authorized to act on his behalf.

In 1989, Paul also opened an account in Liechtenstein in the name of the Foreign Trust with a predecessor to LGT Bank ("LGT Account").

In 1990, the Foreign Trustee formed a company in the British Virgin Islands ("Foreign Corporation"), whose ownership was memorialized solely by bearer shares. Then, the Foreign Trustee arranged for another company ("Nominee") to act as principal for the Foreign Corporation, holding the bearer shares. Next, the Nominee opened an account at Standard Chartered Bank, presumably in the British Virgin Islands ("Standard Chartered Account"). The DOJ alleges that all documents related to this international structure were either signed or initialed by Paul.

Later, in 1990, Paul instructed the Foreign Trustee to arrange for "suitable documentation" between the Domestic Company and the Foreign Corporation, showing that the former was supposedly paying the latter "inspection fees." It appears that the money flowed in the following manner: The Foreign Corporation would send invoices to the Domestic Company for "inspection services"; the Domestic Company would send payment of the invoices to the Standard Chartered Account; and the Nominee would cause the funds to be transferred to the LGT Account, which was held directly by the Foreign Trust. The DOJ claims that (i) the Foreign Corporation never performed any "inspection services," and (ii) the purpose of the foreign entities, accounts, and transactions was to "disguise" transfers of pre-tax funds from the Domestic Company to Paul.

In 2004, Paul traveled to Liechtenstein with his three sons, withdrew $100,000 from the LGT Account, kept $25,000 for himself, and divided the remainder equally between his sons. During this trip in 2004, the Foreign Trustees allegedly notified Paul that the arrangement might trigger U.S. tax and information-reporting issues for Paul and suggested that he seek advice from a U.S. tax professional. Paul agreed to act as the U.S. agent for the Foreign Trust during this same trip, likely without appreciating the duties associated with such title.

V. Protracted Battle with the IRS and DOJ

Garrity is fascinating for a number of reasons, one of which is that the fight with the U.S. government has involved five rounds thus far. They are described below.

A. Round One—Income Tax Case

The IRS issued a Notice of Deficiency in 2011 for unpaid taxes of $65,147, accuracy-related penalties of $13,029, and interest charges related to the 2005 Form 1040. Representatives of Paul's estate filed a timely Petition, and the case now sits with the Tax Court.[27] This litigation has stalled for approximately six years, since 2013, awaiting resolution of issues in other courts. The most recent Order from the Tax Court aptly describes the situation:

> This case [involving tax underpayments and accuracy-related penalties for 2005] was on the Court's May 20, 2013 trial calendar for Buffalo, New York, *but is only a small piece of much larger legal troubles*. The Court put it on a long-term status-report track, and the parties report that the government's claim for [FBAR] penalties recently led to a jury verdict in U.S. District Court. Post-trial motions and a likely appeal await, and it is ordered that the parties file another status report on or before June 21, 2019, to describe their progress toward settlement or a narrowing of the issues to be tried, and any relevant developments in the probate-court and district-court matters.[28]

B. Round Two—FBAR Penalty Case

Paul died in February 2008, at the age of 84, after a long battle with brain cancer and related illnesses. In May 2008, just three months after his death, the IRS started a civil audit.

In October 2009, representatives of Paul's estate filed various tax returns, international information returns, and FBARs for 2003 through 2008, apparently attempting to participate in the Offshore Voluntary Disclosure Program ("OVDP"). The court pleadings are unclear, but the important point is that the IRS, predictably, rejected the OVDP application because the audit had already started many months earlier.

As anyone who regularly defends taxpayers with international tax problems would guess, the audit did not go well. Among other things, the IRS assessed a willful FBAR penalty for 2005 related to the LGT Account. The balance in the account on the date of the FBAR violation (*i.e.*, June 30, 2006) was at least $1,873,382; therefore, the IRS asserted a penalty equal to 50 percent of that amount, or $936,691.

The DOJ made the following allegations with respect to the FBAR violation for 2005: (i) Paul did not report the existence of the LGT Account on Schedule B to the 2005 Form 1040 in response to the foreign account question; (ii) Paul did not report any income generated by the Foreign Trust or the LGT Account on his 2005 Form 1040; (iii) Paul executed his 2005 Form 1040 under penalties of perjury, thereby indicating that he had reviewed Schedule B; (iv) Paul did not notify his accountant about the LGT Account; and (v) Paul failed to file an FBAR disclosing the LGT Account.

Taxpayers, likewise, are frequently clueless about what fighting the IRS on an international matter really entails, which can create even bigger troubles. A recent case, Garrity, *helps put these matters in context.*

The DOJ later clarified its position in the following manner:

> [T]he government has not merely asserted that [Paul] "should have known" of the FBAR requirement. Rather, the government will show that [Paul] acted willfully in failing to file an FBAR because either he knew that he had to file an FBAR (actual knowledge), or he acted with reckless disregard of his FBAR requirement (willful blindness). Presumably, the Defendants equate the "reckless disregard" standard with "should have known." But the standards are not the same. The government is alleging that [Paul] acted with reckless disregard in that he failed to inquire or learn that he had a requirement to file an FBAR after he was specifically alerted to the fact that he needed to do so, and thus [Paul] was "willfully blind" to the FBAR requirement. The government is not arguing that he "should have known" to file an FBAR simply because it is the law.[29]

After clarifying its tax and legal positions, the DOJ identified for the District Court what it calls "just a sample" of the actions and inactions that it intended to prove at trial to demonstrate that Paul's FBAR violation was willful. First, Paul signed and filed his 2005 Form 1040, checking the "no" box in response to the foreign-account question on Schedule B. Second, Paul exhibited "willful blindness" by not reviewing the instructions, explicitly cross-referenced in Schedule B, about the need to report

foreign financial accounts.[30] Third, Paul completed the "organizer" provided by his longstanding accountant in connection with the 2005 Form 1040, falsely indicating that he did not have an interest in a foreign account.[31] Fourth, Paul filed at least one FBAR in earlier years for the Domestic Company, meaning that he knew of its existence and purpose.[32] Fifth, Paul was a sophisticated businessman, who formed the Foreign Trust, instructed the Foreign Trustee to open the LGT Account, and personally visited Liechtenstein in 2004 and withdrew funds.[33] Finally, Paul was told in 2004 to consult U.S. tax advisors about potential tax and information-reporting duties related to the Foreign Trust and LGT Account, but he did not do so.[34]

Ultimately, the DOJ filed a collection lawsuit in District Court.

Many FBAR cases are decided by judges, but the representatives in *Garrity* opted for a jury, presumably seeking some leniency from a group of Paul's supposed peers. The members of the jury sided with the DOJ on all points, rendering the following decisions: (i) Paul had a financial interest in, signature authority over, or some other type of authority over the unreported LGT Account in 2005; (ii) his failure to file the 2005 FBAR was "willful"; and (iii) the amount of the FBAR penalty assessed by the IRS was equal to, or less than, 50 percent of the balance in the LGT Account as of the date of the violation. Notably, the verdict did *not* contain a specific dollar amount.

C. Round Three—Form 3520 and Form 3520-A Penalty Case

As explained above, Paul established the Foreign Trust in 1989. He was named the primary beneficiary from inception, and, while he was alive, he retained the right to amend or revoke the governing documents. Paul entered into an agreement with the Foreign Trustee, pursuant to which it appointed the members of the Board of Directors for the Foreign Trust, all of whom were required to act in accordance with instructions from Paul or somebody acting on Paul's behalf. Based on these facts, the U.S. government took the position that Paul "exercised complete control" over the Foreign Trust, and it should be treated as a foreign grantor trust for U.S. tax purposes, necessitating the filing of Forms 3520 and Forms 3520-A.

The IRS assessed penalties in December 2012 for unfiled Forms 3520 for 1996, 1997, 1998, and 2004, as well as for unfiled Forms 3520-A for 1997 through 2008. When the representatives of Paul's estate refused to pay, the DOJ filed a collection lawsuit in District Court, seeking a total of $1,504,388.[35]

The representatives challenged the DOJ on two grounds. First, with respect to Forms 3520, they argued that the DOJ failed to allege any facts in its Complaint establishing precisely which "reportable transactions" occurred during the relevant years.[36] Second, the representatives claimed that "stacking penalties" against Paul was unconstitutional in that it violated the Eighth Amendment prohibiting excessive fines. The representatives cited to the proposed FBAR penalties of approximately $1.1 million (addressed in another District Court action), accuracy-related penalties of about $13,000 (addressed in Tax Court), and the proposed Forms 3520 and Forms 3520-A penalties reaching over $1.5 million. The representatives urged the District Court to hold that the U.S. government "unconstitutionally stacked" penalties in connection with the same activities, entities, and funds.[37]

As explained further below, the representatives of Paul's estate, for strategic reasons, ultimately agreed to settle the Foreign Trust matters with the DOJ, paying a total of $850,000 to resolve all Form 3520 and Form 3520-A penalties.[38]

D. Round Four—Post-Trial Motion to Reduce FBAR Penalties

To streamline the dispute and not waste resources unnecessarily, the DOJ and representatives of Paul's estate entered into a pre-trial Stipulation in the FBAR penalty case, which indicated that, if the jury were to determine that Paul's FBAR violation for 2005 was "willful," then the parties would be given the opportunity to file post-trial briefs to address two issues pertaining to the proper amount of the penalty: (i) whether, consistent with the recent decision by a District Court in Texas in *Colliot*, the maximum penalty for a willful FBAR violation is $100,000, not 50 percent of the balance of the unreported account[39]; and (ii) whether the total penalty amount, covering FBARs, Forms 3520, and Forms 3520-A are excessive and thus violate the Eighth Amendment of the U.S. Constitution.

1. Summary of Main Arguments by Paul's Estate

The jury in the FBAR penalty case determined that Paul's non-compliance was willful. Accordingly, the two issues identified in the pre-trial Stipulation gained importance. They were addressed in a series of post-trial briefs by the parties, which are summarized below.[40]

a. Capping Willful FBAR Penalties at $100,000.

Taxpayers recently celebrated a significant victory in *Colliot*. This case essentially held that the IRS could not

assert an FBAR penalty exceeding $100,000 per violation, even if such violation were willful.[41]

Here is an abbreviated version of the winning legal/tax argument in Colliot. A previous version of 31 USC §5321(a)(5) allowed the Treasury Department to impose willful FBAR penalties equal to, the greater of, (i) $25,000 or (ii) the balance of the unreported account up to $100,000. The related regulation promulgated *via* notice-and-comment rulemaking, 31 CFR §103.57, reiterated that "[f]or any willful violation committed after October 26, 1986 … the Secretary may assess upon any person a civil penalty … not to exceed the greater of the amount (not to exceed $100,000) equal to the balance in the account at the time of the violation, or $25,000."[42]

In 2002, the Treasury Department delegated authority to assess FBAR penalties to the FinCEN, specifically stating that the related regulations would be unaffected by such transfer of power and would continue in effect "until superseded or revised."[43] Roughly six months later, FinCEN re-delegated the authority to assess FBAR penalties to the IRS.[44]

In 2004, Congress amended 31 USC §5321 to raise the maximum willful FBAR penalties.[45] Under the revised statute, willful FBAR penalties increased to a (i) minimum of $100,000 and (ii) a maximum of 50 percent of the balance in the unreported account at the time of the violation.[46] Despite this change by Congress, the regulations remained unchanged; that is, 31 CFR §103.57 continued to indicate that the willful FBAR penalty was capped at $100,000.

FinCEN later renumbered 31 CFR §103.57 as part of a large-scale reorganization of regulations; it is now called 31 CFR §1010.820. FinCEN also amended part of the relevant regulation for inflation.[47] However, FinCEN did *not* revise the regulation to account for the increased maximum penalty, enacted by Congress in 2004, ranging from $100,000 to 50 percent of the balance in the unreported account.

31 USC §5321(a)(5), in its current form, gives the Treasury Department discretion to determine the amount of willful FBAR penalties, so long as they do not exceed the ceiling set by 31 USC §5321(a)(5)(C) (*i.e.*, 50 percent of the account balance at the time of the violation). However, 31 CFR §1010.820, a regulation validly issued many years ago, never changed, and still in effect, limits the penalty to $100,000. The U.S. Supreme Court has held that rules issued *via* the notice-and-comment procedures must be repealed in the same manner.[48] 31 CFR §1010.820 has *not* been repealed; it was in effect when Paul allegedly committed the willful FBAR violation, and also when the IRS assessed the related FBAR penalty for 2005.

Based on the preceding argument, as supplemented in the post-trial briefing with the District Court, the representatives of Paul's estate took the position that the FBAR penalty for 2005 should be lowered from $936,691 to $100,000.

b. Large and "Stacked" Penalties Are Unconstitutional. The representatives of Paul's estate also advanced the following argument in challenging the FBAR penalty. The Eighth Amendment to the U.S. Constitution states that "[e]xcessive bail shall not be required, *nor excessive fines imposed*, nor cruel and unusual punishments inflicted." Under the relevant two-prong standard developed by the Supreme Court, the Eighth Amendment will invalidate a penalty if (i) it is at least partly punitive, and (ii) it is "grossly disproportional" to the level of the violation.

Taxpayers with undeclared foreign accounts, assets, entities and/or income often find themselves engaged in a multi-faceted war against the U.S. government.

The representatives of Paul's estate contend that both prongs are met in *Garrity* because the FBAR penalty is based solely on the value of the unreported LGT Account and bears no relation to any financial loss to the government. In this regard, they pointed out that the jury upheld the FBAR penalty "with no proof of harm presented by the government"[49] and "[t]he government set forth no evidence that the penalties … bear any relationship whatsoever—rational or irrational—to an actual loss or harm to the government."[50] Moreover, the representatives argued that applicable law allows for a "maximum" FBAR penalty, rather than setting a "mandatory" penalty, which tends to indicate that the highest penalty, such as the one asserted against Paul, is only appropriate in the most egregious circumstances.[51] Unlike in previous FBAR cases upholding large penalties, the representatives claim that Paul's situation did not involve tax evasion or other illegal activities. The representatives also underscored that the *civil* FBAR penalty asserted against Paul was nearly four times the maximum fine for the same *criminal* violation.[52] In addition, the representatives pointed out that

the IRS "simply stacked" multiple penalties for FBAR, Form 3520, and Form 3520-A violations to trigger a "massive combined penalty" of more than $2.5 million, which far exceeds the total amount in the unreported LGT Account.[53] Lastly, the representative asked the District Court to consider the overall economic effect, because, in addition to the penalties, Paul's estate already paid approximately $1 million in U.S. estate tax on the value of the Foreign Trust.[54]

2. Summary of Main Arguments by the DOJ

The DOJ disagreed with all points made by the representatives of Paul's estate, of course. The argument by the DOJ regarding the interplay between statutory provisions, congressional acts, and the relevant regulations was, as one would expect, dense and technical. Perhaps the most interesting aspect was the commentary about whether an FBAR penalty for the unreported LGT Account, in conjunction with Form 3520 and Form 3520-A penalties for the unreported Foreign Trust, violates the restriction in the Eighth Amendment against "excessive fines."

Garrity is an interesting case for many reasons. For starters, it involves income taxes, estate taxes, and a long list of international penalties. Its duration is also notable.

The DOJ denied that these items are related in any manner, considering that they are imposed under entirely separate parts of the U.S. Code (*i.e.*, Title 31 for FBAR penalties and Title 26 for Form 3520 and Form 3520-A penalties) and that they relate to different behaviors (*i.e.*, failing to report information about foreign accounts versus foreign trusts). Nevertheless, the DOJ surmised that Paul's estate figures that they are interrelated because Paul established the Foreign Trust solely for purposes of holding the LGT Account, such that all penalties arise out of the same conduct.[55]

In addition to the fact that the penalties are not technically related, the DOJ urged the District Court to reject the "stacking" argument for the following reasons. First, the DOJ explained that taxpayers are free to organize their affairs in the manner they choose, but they are stuck with the tax consequences of their choices. Here, Paul elected to hold the LGT Account through the Foreign Trust and report neither to the IRS; therefore, his estate must live with the ramifications.[56] Second, the FBAR penalty and Form 3520 and Form 3520-A penalties are not considered "fines" for purposes of the Eighth Amendment because they serve a remedial, not punitive, purpose.[57] Third, the fact that the U.S. estate tax paid by Paul's estate took into account the value of the Foreign Trust should be disregarded because, as the DOJ flippantly put it, "[a]pparently, Defendants want credit for complying with their obligation to pay taxes."[58] Finally, the DOJ explained that the "stacking" argument was premature because (i) Paul's estate was challenging at the same time, in a separate District Court action, the Form 3520 and Form 3520-A penalties, (ii) until such penalties have been conclusively determined, it would be improper to consider their impact, if any, on the FBAR penalty, and (iii) the District Court should focus solely on the FBAR penalty issue, and obligate Paul's estate to raise the "stacking" issue subsequently in the Form 3520 and Form 3520-A penalty action.[59]

Paul's estate then took strategic action to place the "stacking" argument properly before the District Court in the FBAR penalty case. With how-do-you-like-that flair, Paul's estate announced the settlement of the Form 3520 and Form 3520-A issue, as follows:

> In the [DOJ's] opposition to Defendants' motion, it stated that it was premature to consider the Eighth Amendment argument in relation to the 3520 Case until the penalties in that case are "fixed" by a judgment. Recently, however, penalties in the 3520 Case became "fixed" due to a settlement between [the DOJ] and Defendants, leading to dismissal of that case. Under the executed Settlement Agreement, Defendants paid $850,000 to the [DOJ], which the Court can take into account when considering Defendants' motion. That fixed sum of $850,000, in conjunction with the FBAR penalty, and in view of the net assets of the [Foreign Estate] following payment of estate taxes to the Government, requires a reduction in the FBAR penalty to avoid a violation of the Eighth Amendment. The [DOJ's] argument that the constitutional issue is premature is now moot.[60]

E. Round Five—Probate Court

The DOJ also filed a claim in the Probate Court against Paul's estate, presumably requesting an amount equal to all the liabilities described in the preceding suits in Tax Court and District Court.[61]

VI. Conclusion

Garrity is an interesting case for many reasons. For starters, it involves income taxes, estate taxes, and a long list of international penalties. Its duration is also notable. The alleged violations by Paul occurred in 1996 through 2008, the IRS started its audit in 2008, and, more than a decade later, only one of the many cases (pending in Tax Court, District Court, and Probate Court) has been resolved, and that is solely because the representatives of Paul's estate finally decided to settle, as a strategic matter, to obligate the District Court to consider their novel FBAR arguments. Finally, *Garrity* will result in a legal opinion regarding two fundamental issues to taxpayers, namely, whether willful FBAR penalties must be capped at $100,000 per violation, and whether the IRS is constitutionally prohibited from "stacking" FBAR penalties and information-reporting penalties. Regardless of the District Court's ultimate decision about the appropriate size of the FBAR penalty, *Garrity* is already valuable in helping taxpayers understand the complexities of defending themselves against international challenges by the IRS and DOJ.

ENDNOTES

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1 *D.M. Garrity, P.G. Garrity, Jr., and P.M. Sterczala, as fiduciaries of the P.G. Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. Conn. 2018).

2 P.L. 91-508, Title I and Title II (Oct. 26, 1970).

3 P.L. 91-508, Title I and Title II (Oct. 26, 1970) at §202.

4 P.L. 108-357 (Oct. 22, 2004).

5 31 USC §5321(a)(5)(A) (as in effect before Oct. 22, 2004).

6 31 USC §5321(a)(5)(B)(ii) (as in effect before Oct. 22, 2004).

7 31 USC §5321(a)(5)(A).

8 31 USC §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 USC §5321(a)(5)(B)(ii).

9 31 USC §5321(a)(5)(C)(i).

10 31 USC §5314; 31 CFR §1010.350(a).

11 For a detailed analysis of the Form 8938 filing requirement, *see* the following articles by the same author: Hale E. Sheppard, *The New Duty to Report Foreign Financial Assets on Form 8938: Demystifying the Complex Rules and Severe Consequences of Noncompliance*, INT'L TAX J., 2012, at 11; Hale E. Sheppard, *Form 8938 and Foreign Financial Assets: A Comprehensive Analysis of the Reporting Rules After IRS Issues Final Regulations*, INT'L TAX J., 2015, at 25; Hale E. Sheppard, *Specified Domestic Entities Must Now File Form 8938: Code Sec. 6038D, New Regulations in 2016, and Expanded Foreign Financial Asset Reporting*, INT'L TAX J., 2016, at 5; Hale E. Sheppard, *Canadian Retirement Plans: What Does Revenue Procedure 2014-55 Mean for U.S. Tax Deferral, Form 8891, Form 8938, and the FBAR?* INT'L TAX J., 2016, at 25; and Hale E. Sheppard, *Unlimited Assessment-Period for Form 8938 Violations: Ruling Shows IRS's Intent to Attack Multiple Tax Returns*, TAXES, 2017, at 31; Hale E. Sheppard, *Extended Assessment Periods and International Tax Enforcement: Rafizadeh v. Commissioner, Unreported Foreign Assets, and Use of FATCA Weapons*, TAXES, 2018, at 35 and J. INT'L TAXATION 25 (2018).

12 Code Sec. 6048(a)(1); Code Sec. 6048(a)(4).

13 Code Sec. 6048(c)(1).

14 Code Sec. 6677(a).

15 Code Sec. 6677(d).

16 Code Sec. 6048(b)(1). The grantor trust rules are located in Code Secs. 671 to 679.

17 Code Sec. 678(a)(1).

18 Code Sec. 679(a)(1).

19 Code Sec. 6677(b).

20 Code Sec. 6677(d).

21 IRM 4.26.17.3 (Jan. 1, 2007); IRM 20.1.9.2 (Apr. 22, 2011); IRM 20.1.9.2.1 (Apr. 22, 2011); IRM 20.1.9. 22 (Apr. 22, 2011).

22 Code Sec. 6213(a).

23 *See* Hale E. Sheppard, *Two More Blows to Foreign Account Holders: Tax Court Lacks FBAR Jurisdiction and Bankruptcy Offers No Relief from FBAR Penalties*, J. TAX PRACTICE & PROCEDURE, 2009, at 27.

24 31 USC §5321(b)(2).

25 IRM 20.1.9.2 (Apr. 22, 2011) (emphasis added); IRM Exhibit 20.1.9-4; *see also* CCA 201226028.

26 *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. Conn. 2018). The author obtained and reviewed the following documents pertaining to this case in preparing this article: Complaint and Jury Demand filed February 20, 2015; Defendant's Answer and Affirmative Defenses filed April 24, 2015; Expert Report by Howard B. Epstein, CPA dated April 28, 2017; Memorandum and Order regarding Standard of Proof filed April 3, 2018; Plaintiff's Motion in Limine to Exclude the Testimony of Howard B. Epstein filed April 3, 2018; Plaintiff's Memorandum in Support of Its Motion in Limine to Exclude Opinion Testimony of Howard B. Epstein filed April 3, 2018; Defendant's Opposition to Plaintiff's Motion in Limine to Exclude Opinion Testimony of Howard B. Epstein filed April 24, 2018; Joint Trial Memorandum filed May 4, 2018; Stipulation regarding Determination of Factual and Legal Issues filed May 30, 2018; and Memorandum and Order regarding Proposed Expert Testimony of Howard B. Epstein filed June 1, 2018; Jury Instructions filed June 12, 2018; Verdict Form filed June 13, 2018; Judgment filed June 13, 2018.

27 *Garrity Est., Deceased, Garrity, Garrity, Jr., and Sterczala, co-executors*, Tax Court Docket No. 006561-12.

28 *Garrity Est., Sr.*, Tax Court Docket No. 006561-12, Order dated December 26, 2018.

29 *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. Conn. 2018). Plaintiff's Memorandum in Support of Its Motion in Limine to Exclude Opinion Testimony of Howard B. Epstein filed April 3, 2018, at 8.

30 *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. Conn. 2018). Plaintiff's Memorandum in Support of Its Motion in Limine to Exclude Opinion Testimony of Howard B. Epstein filed April 3, 2018, at 4–5.

31 *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. Conn. 2018). Plaintiff's Memorandum in Support of Its Motion in Limine to Exclude Opinion Testimony of Howard B. Epstein filed April 3, 2018, at 5.

32 *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. Conn. 2018). Plaintiff's Memorandum in Support of Its Motion in Limine to Exclude Opinion Testimony of Howard B. Epstein filed April 3, 2018, at 5.

33 *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. Conn. 2018). Plaintiff's Memorandum in Support of Its Motion in Limine to Exclude Opinion Testimony of Howard B. Epstein filed April 3, 2018, at 5–6.

34 *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. Conn. 2018). Plaintiff's Memorandum in Support of Its Motion in Limine to Exclude Opinion Testimony of Howard B. Epstein filed April 3, 2018, at 5–6.

35 *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr.*, Case No. 2:18-cv-00111 (D.C. Conn.). The author obtained and reviewed the following documents pertaining to this

case in preparing the article: Complaint filed January 18, 2018; Defendant's Answer and Affirmative Defenses filed February 26, 2018; Stipulation for Dismissal dated January 28, 2019.

[36] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr.*, Case No. 2:18-cv-00111 (D.C. Conn.). Defendant's Answer and Affirmative Defenses filed February 26, 2018.

[37] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr.*, Case No. 2:18-cv-00111 (D.C. Conn.). Defendant's Answer and Affirmative Defenses filed February 26, 2018.

[38] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr.*, Case No. 2:18-cv-00111 (D.C. Conn.). Stipulation for Dismissal dated January 28, 2019.

[39] *Colliot*, No. AU-16-CA-01281-SS (W.D. Tex. May 16, 2018).

[40] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. Conn.). The author reviewed the following documents in preparing this portion of the article: Defendants' Motion to Alter and Reduce Judgment filed July 11, 2018; Plaintiff United States of America's Motion to Amend Judgment filed July 11, 2018; Defendants' Opposition to Plaintiff USA's Motion to Amend Judgment filed July 20, 2018; Defendants' Notice of Supplemental Authority Regarding Their Motion to Alter and Reduce Judgment filed July 20, 2018; Plaintiff United States' Response in Opposition to Defendants' Motion to Alter and Reduce Judgment filed August 1, 2018; Defendants' Reply Memorandum in Support of Their Motion to Alter and Reduce Judgment filed August 15, 2018; and Defendants' Notice of Supplemental Information for Post-Verdict Motion under Rule 59 filed January 21, 2019.

[41] *Colliot* was later followed by *Wadhan*, WL 3454973 (D. Colo. July 18, 2018), of which the District Court in *Garrity* was timely notified. *See* Defendants' Notice of Supplemental Information for Post-Verdict Motion under Rule 59 filed January 21, 2019.

[42] Amendments to Implementing Regulations Under the Bank Secrecy Act, 52 FR 11436, 11445–46 (1987).

[43] Treasury Order 180-01, 67 FR 64697 (2002).

[44] Memorandum of Agreement and Delegation of Authority for Enforcement of FBAR Requirements (2002).

[45] American Jobs Creation Act of 2004, P.L. 108-357, §821, 118 Stat. 1418 (2004).

[46] 31 USC §5321(a)(5)(C).

[47] Civil Monetary Penalty Adjustment and Table, 81 FR 42503, 42504 (2016).

[48] *Perez v. Mortgage Bankers Ass'n*, SCt, 135 SCt 1199, 1206 (2015).

[49] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. Conn.). Defendants' Motion to Alter and Reduce Judgment filed July 11, 2018, at 14.

[50] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. D. Conn.). Defendants' Motion to Alter and Reduce Judgment filed July 11, 2018, at 15.

[51] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. D. Conn.). Defendants' Motion to Alter and Reduce Judgment filed July 11, 2018, at 15.

[52] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. D. Conn.). Defendants' Motion to Alter and Reduce Judgment filed July 11, 2018, at 17.

[53] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. D. Conn.). Defendants' Motion to Alter and Reduce Judgment filed July 11, 2018, at 17.

[54] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. D. Conn.). Defendants' Motion to Alter and Reduce Judgment filed July 11, 2018, at 17.

[55] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. D. Conn.). Plaintiff United States' Response in Opposition to Defendants' Motion to Alter and Reduce Judgment filed August 1, 2018, at 38–39.

[56] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. D. Conn.). Plaintiff United States' Response in Opposition to Defendants' Motion to Alter and Reduce Judgment filed August 1, 2018, pg. 39.

[57] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. D. Conn.). Plaintiff United States' Response in Opposition to Defendants' Motion to Alter and Reduce Judgment filed August 1, 2018, at 39.

[58] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. D. Conn.). Plaintiff United States' Response in Opposition to Defendants' Motion to Alter and Reduce Judgment filed August 1, 2018, at 39.

[59] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. D. Conn.). Plaintiff United States' Response in Opposition to Defendants' Motion to Alter and Reduce Judgment filed August 1, 2018, at 40.

[60] *Garrity, Garrity, Jr., and Sterczala, as fiduciaries of the Garrity Est., Sr., deceased*, Case No. 3:15-cv-243 (D.C. D. Conn.). Defendants' Notice of Supplemental Information for Post-Verdict Motion under Rule 59 filed January 21, 2019.

[61] *Garrity Est., Sr.,* Case No. 08-0211 (Saybrook, Conn. Probate Court) (filed March 3, 2008).