



First Taxpayer Victory in a “Willful” FBAR Penalty Case: Analyzing the Significance of *Bedrosian* for Future Foreign Account Disputes (Part 1)

HALE E. SHEPPARD

After a series of disappointing taxpayer losses in “willful” FBAR cases, taxpayers finally scored a victory in *Bedrosian*.

Taxpayers with unreported foreign accounts have faced a lot of bad news in recent years, as the U.S. government claimed victory in four straight cases starting in 2012, asserting the highest possible penalties for “willful” violations of the duty to file Forms TD F 90-22.1 or FinCEN Forms 114 (FBARs). Things changed in late 2017, though, when a taxpayer managed to buck the trend, convincing a district court that, despite a fairly significant amount of unfavorable evidence, the omission of a multimillion dollar account from his 2007 FBAR constituted mere negligence, not willful behavior.

This case, *Bedrosian*,¹ has triggered considerable excitement within the tax community, which is both logical and predictable. The job now is to closely analyze the case to understand whether, or to what extent, the positive result in *Bedrosian* can benefit other taxpayers

facing steep FBAR penalties assessed by the IRS and litigated by the U.S. Department of Justice (DOJ). This task is far less exciting than simply jumping on the *Bedrosian* bandwagon, and it requires a detailed review of the first four taxpayer losses in the FBAR arena. This two-part article embraces the challenge and, for those readers with the stamina to get through all the material, describes the evolution of civil “willful” FBAR cases, with insights available only to those diligent enough to scour all documents filed with the courts in each case. Part one of this article will discuss the background of FBAR penalties and the first two taxpayer loss cases.

Background on FBAR Duties and Penalties

Congress enacted the Bank Secrecy Act in 1970.² One purpose of this leg-

islation 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 Applicable law, regulations, and FBAR instructions require the filing of an FBAR in cases where: (1) a U.S. person, (2) had a direct financial interest in, an indirect financial interest in, signature authority over, or some other type of authority over, (3) one or more financial accounts, (4) located in a foreign country, (5) and the aggregate value of such account or accounts exceeded \$10,000, (6) at any point during the calendar year at issue.⁴

Concerned with widespread non-compliance, the U.S. government has taken certain actions in recent years. Notably, the Treasury Department transferred authority to enforce FBAR duties to the IRS in 2003.⁵ The IRS is now empowered to investigate potential FBAR violations, issue summonses, assess civil penalties, issue administrative rulings, and take “any other action reasonably necessary” to enforce the FBAR rules.⁶

Congress, for its part, enacted new FBAR penalty provisions in 2004 as part of the American Jobs Creation Act (Jobs Act).⁷ Under the law in existence before the Jobs Act, the government could assert civil penalties against taxpayers only where it could demonstrate that they “willfully” violated the FBAR rules.⁸ If the government managed to satisfy this high evidentiary standard, it could impose relatively small FBAR penalties, ranging from \$25,000 to \$100,000.⁹

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.¹⁰ In the case of non-willful violations, the maximum penalty is \$10,000.¹¹ The Jobs Act calls for higher maximum penalties where willfulness exists. Specifically, in situations where a taxpayer deliberately failed to file an FBAR, the IRS may now assert a penalty

Hale E. Sheppard, B.S., M.A., J.D., LL.M., LL.M.T., is a Shareholder in the Tax Controversy Section of Chamberlain Hrdlicka, Chair of the International Tax Group, and Member of the Executive Committee. Hale specializes in tax audits, tax appeals, and tax litigation. You can reach Hale by phone at (404) 658-5441 or by e-mail at hale.sheppard@chamberlainlaw.com.

equal to \$100,000 or 50% of the balance in the account at the time of the violation, whichever is greater.¹² Given the astronomical balances in some unreported accounts, FBAR penalties under the Jobs Act can be enormous.

Generally, U.S. citizens and residents have four main duties when they hold a reportable interest in a foreign financial account: (1) report all income generated by the account on their federal income tax return (i.e., Form 1040, U.S. Individual Income Tax Return); (2) check the “yes” box in Part III, Foreign Accounts and Trusts, of Schedule B, Interest and Ordinary Dividends, to Form 1040 to disclose the existence and location of the foreign account; (3) electronically file an FBAR; and (4) report the foreign account on a Form 8938, Statement of Specified Foreign Financial Assets, depending on the facts.¹³

With respect to the second duty described above, Part III of Schedule B to Form 1040 contains an FBAR inquiry and a cross-reference. The IRS has slightly modified and expanded this language over the years, with the materials for 2016 stating the following:

At any time during 2016, 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.

First Case Addressing “Willful” FBAR Civil Penalties: *Williams*

The first case concerning the imposition of a civil “willful” FBAR penalty was *Williams*, a multi-year, multi-issue case, with stops in the U.S. Tax Court (*Williams I*),¹⁴ the district court (*Williams II*),¹⁵ and, ultimately, the Fourth Circuit Court of Appeals (*Williams III*).¹⁶

The Key Facts in *Williams*

Synthesizing various court documents and decisions, the facts underlying the *Williams* cases are as follows.¹⁷ The taxpayer was a U.S. citizen at all relevant times. He earned an undergraduate degree from the University of North Carolina, followed by a law degree from one of the top law schools in the country, New York University. He began his legal career as an associate attorney with a major international firm. He later worked for Mobil Oil Corporation, where he

NOTES

¹ 120 AFTR2d 2017-5832 (DC PA, 2017).

² P.L. 91-508, Title I and Title II (10/26/70).

³ *Id.* at section 202.

⁴ 31 USC section 5314; 31 CFR section 1010.350(a).

⁵ 68 Fed. Reg. 26489 (5/16/03).

⁶ 31 CFR section 103.56(g), 68 Fed. Reg. 26489 (5/16/03).

⁷ P. L. 108-357 (10/22/04).

⁸ 31 USC section 5321(a)(5)(A) (as in effect before 10/22/04).

⁹ 31 USC section 5321(a)(5)(B)(ii) (as in effect before 10/22/04).

¹⁰ 31 USC section 5321(a)(5)(A).

¹¹ 31 USC section 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 section 5321(a)(5)(B)(ii).

¹² 31 USC section 5321(a)(5)(C)(i).

¹³ For a detailed analysis of the Form 8938 filing requirement, see Sheppard, “The New Duty to Report Foreign Financial Assets on Form 8938: Demystifying the Complex Rules and Severe Consequences of Noncompliance,” 38(3) International Tax Journal 11 (2012); Sheppard, “Form

8938 and Foreign Financial Assets: A Comprehensive Analysis of the Reporting Rules after IRS Issues Final Regulations,” 41(2) International Tax Journal 25 (2015); and Sheppard, “Specified Domestic Entities Must Now File Form 8938: Section 6038D, New Regulations in 2016, and Expanded Foreign Financial Asset Reporting,” 42(3) International Tax Journal 5 (2016).

¹⁴ *Williams*, 131 TC 54 (2008).

¹⁵ *Williams*, 106 AFTR2d 2010-6150 (DC Va., 2010).

¹⁶ *Williams*, 489 Fed. Appx. 655, 110 AFTR2d 2012-5298 (CA-4, 2012).

¹⁷ The facts were derived from various pleadings, briefs, and other documents filed by the parties in *Williams I*, *Williams II*, and *Williams III*, as well as the decisions in *Williams*, TCM 2009-81 (Tax Court decision granting the IRS’s motion for partial summary judgment on the issue of whether the taxpayer’s guilty plea to tax evasion in the earlier criminal trial collaterally estopped him from contesting in the subsequent civil tax litigation that he fraudulently underpaid his federal income taxes for 1993 through 2000); and *Williams*, TCM 2011-89 (Tax Court decision upholding the federal income taxes and civil penalties for 1993 through 2000).

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. (ALQI), a British Virgin Islands corporation controlled by the taxpayer. The accounts were designed to hold funds the taxpayer earned from 1993 through 2000 in connection with his oil trading in Russia and his consulting for various companies through ALQI.

The taxpayer used the same U.S. accountant for all relevant years, 1993 to 2000. He did not discuss the foreign ac-

compliance Initiative (OVCI), in January 2003.¹⁸ The OVCI offered lenient settlement terms to those taxpayers who came forward of their own free will. The taxpayer, enticed by this offer, submitted his OVCI application in February 2003. The IRS rejected his application, citing the fact that the OVCI was not available to taxpayers whose applications arrived after the IRS had already initiated a civil audit or criminal investigation of the taxpayer or a related entity, or after the IRS had received information from a third-party alerting the IRS to the taxpayer's noncompliance.¹⁹

The IRS pursued criminal charges against the taxpayer. In May 2003, he agreed to plead guilty to one count of criminal tax evasion and one count of

to assist in hiding my true income from the IRS and evade taxes thereon, until I filed my 2001 tax return.

At the criminal sentencing hearing in September 2003, the court imposed the following punishment on the taxpayer: nearly four years in jail, three years of supervised release, a \$25,000 fine, and more than \$3.5 million in restitution.

The IRS initiated a civil examination against the taxpayer approximately one year after the criminal sentence was announced. The revenue agent assigned to the case asked the taxpayer, in January 2007, to file an FBAR for 2000. The taxpayer claimed that this was the first time that he learned of the FBAR filing requirement. As part of the examination process, the revenue agent indicated that he would not conclude the matter until the taxpayer filed FBARs for all years going back to 1993. The taxpayer did so.

In May 2007, under the FBAR law in effect for 2000, the revenue agent asserted the maximum penalty of \$100,000 per account for the two ALQI accounts on the grounds that the taxpayer "willfully" violated the law.

In addition to asserting the FBAR penalty for 2000, the IRS issued a notice of deficiency in October 2007, proposing significant federal income tax liabilities, accuracy-related penalties, and civil fraud penalties for all eight years, 1993 through 2000. The IRS was able to attack the taxpayer on tax issues going back to the beginning because no statute of limitations exists in cases involving fraudulent Forms 1040.²⁰

Williams I: Tax Court Opines on Novel Jurisdictional Issues

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, predictably, filed a motion to dismiss the case for lack of jurisdiction as to the FBAR penalties.²¹ The IRS's theory was that the provision under which FBAR penalties are asserted (i.e., 31 USC section 5321) does not fall within the Tax Court's jurisdiction. This is based



Bedrosian, has triggered considerable excitement within the tax community, which is both logical and predictable.

counts with this accountant. Moreover, when the accountant sent him a questionnaire/organizer in early 2001 to be completed by the taxpayer in order to assist the accountant in preparing the 2000 Form 1040, the taxpayer indicated that he did not have a reportable interest in a foreign account.

Swiss government officials notified the taxpayer in August 2000 of their 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 in November 2000. The next day, the U.S. government directed Switzerland to freeze the accounts, and 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 and related tax issues. The firm met with IRS attorneys in January 2002 to discuss a possible resolution of this case on a non-criminal basis. No such settlement was reached.

The IRS announced a tax amnesty program, the Offshore Voluntary Com-

plaint conspiracy to defraud the U.S. government. This plea agreement was confirmed in June 2003, when the taxpayer allocuted to the following: (1) He opened two bank accounts in the name of ALQI; (2) The purpose of the accounts was to hold funds that he received from foreign sources; (3) During the relevant years, he deposited more than \$7 million into the accounts, and these funds generated more than \$800,000 in passive income; (4) He knew that the funds in the accounts constituted taxable income, but he chose not to report the income to the IRS in order to avoid U.S. taxes; and (5) He was guilty of evading taxes and of conspiring with others to defraud the U.S. of tax revenues. The taxpayer said relatively little in his allocution regarding the nonreporting of foreign accounts, and he never specifically mentioned the FBAR:

I also knew that I had the obligation to report to the IRS and/or the Department of the Treasury the existence of the Swiss accounts, but for the calendar year tax returns 1993 through 2000, I chose not to in order

on Section 7442, which provides that the Tax Court and its divisions “shall have such jurisdiction as is conferred on them by this title [26]”

No Preassessment Tax Court Jurisdiction. 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. For its part, Section 6213(a) provides that the tax in question may not be assessed until the IRS has issued the requisite notice of deficiency. 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), by subtitle B of Title 26 (i.e., estate and gift taxes), or by chapters 41, 42, 43, or 44 in subtitle D of Title 26 (i.e., miscellaneous excise taxes). Therefore, by negative implication, any other taxes and items 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.²²

No Post-Assessment Tax Court Jurisdiction

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*, nor was it broached in the IRS’s motion to dismiss. Nevertheless, the Tax Court addressed this topic. A brief overview on the normal tax collection process helps put this second issue in context. The IRS is required to send a taxpayer

a notice of intent to levy at least 30 days before it seizes his or her property to satisfy tax debts.²³ To dispute the intended governmental taking, a taxpayer may file a Form 12153, Request for Collection Due Process or Equivalent Hearing, which triggers a collection due process (CDP) hearing.²⁴ 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.”²⁵ The settlement officer ultimately issues a notice of determination, which represents the IRS’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.²⁶

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).²⁷ 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 USC section 5321(b)(2), is not a lien or levy, but rather a “civil action to recover a civil penalty;” and (3) Even if the FBAR penalty were a tax subject to the IRS’s lien and levy provisions, the IRS had not issued a no-

tice of determination, which is a prerequisite to filing a petition with the Tax Court.²⁸

In summary, the Tax Court set important precedent in *Williams I*, holding that it lacks jurisdiction to address FBAR issues at both the preassessment stage and collection stage.²⁹

Williams II: District Court Refuses to Uphold FBAR Penalties

A Chronicle of the Briefing Battle. The taxpayer in *Williams* did not hand over the \$200,000 to the IRS after the revenue agent asserted the maximum penalty in May 2007; rather, 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 the district court in April 2009 “for the purpose of collecting outstanding civil penalties.” The government did so pursuant to 31 USC 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 is assessed.

The government then filed a motion for summary judgment on the FBAR penalty issue, with the focus being whether the taxpayer “willfully” failed to file an FBAR for 2000. The government, citing *Ratzlaf*,³⁰ (a case involving a criminal violation of the structuring provisions of the Bank Secrecy Act) and *Sturman*,³¹ (a criminal FBAR case), argued that it only has to prove that the taxpayer intentionally violated “a known legal duty” to prevail. Referring to his earlier guilty plea from 2003, the government maintained that the taxpayer had already admitted in the criminal trial that he knew he had an

NOTES

¹⁸ Rev. Proc. 2003-11, 2003-1 CB 311, section 1.

¹⁹ Rev. Proc. 2003-11, section 4.

²⁰ Section 6501(c)(1).

²¹ The motion raised other issues that are beyond the scope of this article.

²² *Williams*, note 14, *supra*.

²³ Section 6330(a).

²⁴ Sections 6330(a)-(c).

²⁵ Conference Report 105-599, 105th Cong., 2d Sess., 6/24/98, p. 263; Section 6330(c)(3)(C).

²⁶ Section 6330(d); U.S. Tax Court Rule 331(b).

²⁷ Sections 6301, 6230, 6231, 6330, 6331, and 6665.

²⁸ *Williams*, note 14, *supra*.

²⁹ The Tax Court later issued an opinion on the substantive tax issues, holding that the taxpayer, for 1993 through 2000, was liable for federal income taxes on the net consulting income deposited into the ALQI accounts, federal income taxes on the investment income generated by the ALQI accounts, civil fraud penalties on both the consulting income and investment income, and accuracy-related penalties related to tax underpayments resulting from disallowed charitable contribution deductions. *Williams*, TCM 2011-89.

³⁰ 510 U.S. 135 (1994).

³¹ 951 F.2d 1466 (CA-6, 1991).

obligation to report the existence of the Swiss accounts; that the foreign source income deposited into and generated by the such accounts constituted taxable income to him; and 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 guilty plea 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 it eat too” by allocating at the criminal trial to obtain a reduced sentence for acceptance of responsibility, and then attempting to avoid civil FBAR penalties by retracting his earlier statements.

The district court was dissuaded by the government’s argument. In rejecting its motion for summary judgment, the court made two main points. First, the district court noted that the primary issue, whether the taxpayer “willfully” failed to file an FBAR, 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 criminal guilty plea, the district court explained that the real issue in this case is 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 Forms 1040 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 [an FBAR] for tax year 2000.”

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.”

The taxpayer’s counsel countered by arguing here, as he had in previous 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 accounts by having them frozen before the FBAR 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 confirm 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 to \$100,000.

District Court Finds that the Taxpayer Did Not Act “Willfully”. The district court in *Williams II* issued its opinion in favor of the taxpayer in September 2010, basing its determination on two principal factors.

The district court first indicated that the government did not adequately differentiate between simply failing and “willfully failing” to disclose an interest in foreign accounts.³² In this regard, the court explained that, after examining all of 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 Form 1040. The district court acknowledged that the box on Schedule B to 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. However, the district court underscored 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 interview with the

Swiss authorities and the resulting freezing of the accounts. According to the court, these facts “strongly indicate to the Court that [the taxpayer] lacked any motivation to willfully conceal the accounts from authorities after that point.”³³ The district court also noted that subsequent disclosures by the taxpayer, through his representatives, corroborated his lack of willfulness with respect to 2000. In particular, the district court identified the disclosures made by the taxpayer’s attorneys in their meeting with the IRS attorneys in January 2002 and the revelations made in the course of applying for the OVCI in February 2003. These disclosures, noted the district court, indicate the taxpayer’s “consciousness of guilt for evading income taxes, which he never equated with the foreign banking disclosure.”³⁴

The district 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. It held the following on this score:

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.”³⁵

Williams III: Court of Appeals Finds Willfulness

The Government’s Arguments on Appeal. The government, dissatisfied with the taxpayer-favorable decision rendered by the district court, filed a notice of appeal

in November 2010, followed by its opening brief with the Fourth Circuit Court of Appeals. The government raised just two issues in its brief. First, the government asked the Court of Appeals to determine whether the taxpayer, after making various admissions in his prior criminal case, was estopped (judicially, collaterally, or both) from arguing in the subsequent civil case that his failure to file an FBAR for 2000 was not willful. Second, assuming that the taxpayer was not estopped from raising such arguments, the government urged the Court of Appeals to decide that the district court erred in ruling that the taxpayer did not act willfully.³⁶ Given the nature of its analysis and holding, the Court of Appeals never addressed the government's first issue. This article follows suit, focusing solely on the "willfulness" issue.

The government's position on appeal was that the district court erred, as a matter of law, in determining which elements must be present to prove "willfulness" in the context of a civil FBAR violation, as opposed to a criminal one.³⁷ Citing various decisions from the Supreme Court and appellate courts, the government maintained that, where willfulness is a condition of civil liability: (1) the concept of willfulness is broad enough to cover both reckless and knowing violations; (2) it is not necessary to prove that the taxpayer had an improper motive or bad purpose to show willfulness; and (3) evidence of a taxpayer's actions to conceal income, in conjunction with the taxpayer's failure to seek information about foreign account reporting requirements, suffices to show willfulness.³⁸ The government argued that the district court arrived at its conclusion that the taxpayer did not willfully violate the FBAR rules because of its belief that the taxpayer lacked "motivation to willfully conceal" the foreign accounts after November 2000, i.e., after the time that the Swiss authorities had interviewed the taxpayer and frozen the ALQI accounts at the request of the U.S. government. According to the government, the issue of whether the taxpayer had an improper motive for not filing a timely FBAR for 2000 is not determinative of the willfulness

question, so the district court erred in basing its findings on the supposed absence of improper motivation.³⁹

After suggesting that the district court applied the wrong legal standard, the government attacked the facts on which the district court rendered its decision. The government began by emphasizing that the taxpayer's plea in his earlier criminal case was a strong indication of willfulness on the FBAR matter, which the district court wrongly elected to downplay.⁴⁰ The government seized on the following language from the taxpayer's allocution:

I also knew that I had the obligation to report to the IRS and/or the Department of the Treasury the existence of the Swiss accounts, but for the calendar year tax returns 1993 through 2000, I chose not to in order to assist in hiding my true income from the IRS and evade taxes thereon, until I filed my 2001 tax return.

The government essentially argued that a Form 1040 goes to the IRS, while an FBAR gets sent to a special office of the Treasury Department. Thus, the government contended, when the taxpayer previously acknowledged in the criminal case that he knew of his obligation to report the existence of the Swiss accounts "to the Department of the Treasury," logic dictates that he was referring to the FBAR.⁴¹

The government next argued that, even if the taxpayer's motivation were the proper standard in determining willfulness in the civil FBAR context, the district court failed to recognize that the taxpayer had a significant reason for not disclosing the foreign accounts; that is, to hide the millions of pre-tax dollars deposited into the foreign accounts and to hide the passive income generated by such accounts.⁴²

Interestingly, the government then suggested that, despite all the public fanfare to the contrary, the IRS may not be all that effective at identifying foreign accountholders. The taxpayer indicated at various stages of the case that he had no reason whatsoever to conceal anything from the IRS after he met with Swiss authorities about the accounts and his accounts were frozen by the Swiss authorities in November

2000 at the U.S. government's insistence. Stated more colloquially, the taxpayer professed that he had no reason to further hide anything from the IRS once the jig was up. The government, in its opening brief, strained to suggest that: (1) because the taxpayer was using a nominee to hold the account, ALQI, "there was no guaranty that the IRS would be able to connect the dots," and (2) there was no specific evidence in the record as to whether the taxpayer admitted to the Swiss authorities in November 2000 that the ALQI accounts belonged to him or whether he continued to distance himself from such accounts.⁴³

The government then argued that the district court's conclusion that the taxpayer had no motive to further conceal the foreign accounts after November 2000 cannot be reconciled with his interactions with his accountant. In particular, the government pointed out that in January 2001, the taxpayer's accountant sent him the tax questionnaire/organizer related to the Form 1040 for 2000 (i.e., two months after the meeting in Switzerland and the freezing of the accounts), yet the taxpayer checked the "no" box in response to the question about foreign accounts. This, argued the government, shows the taxpayer's ongoing intent to hide the accounts.⁴⁴

The taxpayer's high level of sophistication was the next target for the government. It noted that the taxpayer was a well-educated attorney and international businessman, who had practiced law at a prominent New York law firm, worked as a high-level oil executive, and enjoyed multiple opportunities to

NOTES

³² Williams, note 15, *supra*, at Slip Opinion 7.

³³ *Id.*, at Slip Opinion 8-9.

³⁴ *Id.*, at Slip Opinion 9.

³⁵ *Id.*, at Slip Opinion 9-10.

³⁶ Williams, note 16, *supra*, Opening Brief for U.S. Government, filed 2/25/11, at pp. 2-3.

³⁷ *Id.* at p. 33.

³⁸ *Id.* at pp. 34-35.

³⁹ *Id.* at pp. 35-36.

⁴⁰ *Id.* at p. 36.

⁴¹ *Id.* pp. 36-37.

⁴² *Id.* at p. 38.

⁴³ *Id.* at p. 39.

⁴⁴ *Id.* at pp. 39-40.

learn about the duty to file annual FBARs.⁴⁵ Against this backdrop, the government suggested that it was “highly improbable” that the taxpayer was unaware of his FBAR duties.⁴⁶

Finally, the government tried to downplay some of the taxpayer’s behaviors and highlight others, depending on whether they hurt or helped the government’s case. Certain actions by the taxpayer in later years could be viewed as favorable to the taxpayer. These included meeting with IRS representatives, applying for the OVCI, filing Forms 1040X for past years, and ultimately filing FBARs as part of the examination process. The government

He first explained that his actions in later years (i.e., hiring reputable attorneys and accountants, meeting with IRS attorneys, applying for the OVCI, filing Forms 1040X, etc.) should factor into the analysis. The taxpayer’s attorney framed his argument as a rhetorical question:

If, as the government postulates, [the taxpayer] knew of the FBAR requirement in June 2001 and willfully failed to comply with it, why did he not backfile FBAR reports in the succeeding two years when he and his advisors executed every other conceivable government disclosure, including an amnesty application? Only one rea-

Finally, the taxpayer took issue with the government’s assertion that he had some reason for not disclosing the foreign accounts after November 2000. The taxpayer pointed out that: (1) the application and other documents related to the accounts for ALQI specifically identified the taxpayer as the beneficial owner of the accounts; (2) the Swiss authorities specifically summoned the taxpayer to Switzerland to discuss the accounts; and (3) if the taxpayer were such an educated and sophisticated person, as the government contends, he certainly would have known that the U.S. government would readily link him to ALQI and the accounts held in its name.⁵⁴



The Tax Court set important precedent in *Williams I*, holding that it lacks jurisdiction to address FBAR issues at both the preassessment stage and collection stage.

tried to completely disregard such events, underscoring that the case involved only the duty to file an FBAR as of 6/30/01, and that “disclosures in 2002 and 2003 have no bearing on that question.”⁴⁷

Rebuttal by the Taxpayer. The taxpayer was remarkably brief in his rebuttal to the government’s main arguments. Regarding the government’s contention that the district court erred, as a matter of law, in determining that a taxpayer’s motivation as a factor in gauging willfulness, the taxpayer dismissed this as meritless.⁴⁸ Citing various legal authorities, the taxpayer reasoned that, while willfulness does not require the taxpayer to have an improper motive, a taxpayer’s incentives to conceal or disclose information to the IRS are indeed relevant to determining his subjective intent.⁴⁹

The government’s secondary argument was that, even if the district court used the correct legal standard, its decision not to uphold the FBAR penalty was clearly erroneous as a factual matter for various reasons. The taxpayer countered this argument as follows.

son makes sense: [The taxpayer] had no knowledge of the FBAR requirement, and his advisors never informed him of it.⁵⁰

Next, the taxpayer suggested that his allocation in the criminal case nearly a decade earlier never specifically mentioned the FBAR filing duty or his knowledge thereof. Consequently, it cannot be, as the government contends, highly probative of his willfulness.⁵¹

The taxpayer then challenged the notion that his denial of the existence of foreign accounts in the tax questionnaire/organizer given to his accountant in January 2001 constitutes evidence of his willfulness to conceal the accounts, even after the Swiss authorities interviewed him, and even after the U.S. authorities had frozen his Swiss accounts. The taxpayer had already retained new tax attorneys when his accountant was preparing the Form 1040 for 2000 and he understood that he should not discuss the foreign account matters with anyone other than the attorneys.⁵² The taxpayer also suggested that, at that time, he was already assembling a team to rectify all issues concerning the foreign accounts.⁵³

Decision by the Fourth Circuit Court of Appeals. The Fourth Circuit Court of Appeals began its analysis by criticizing the legal standards on which the district court made its taxpayer-friendly decision. In particular, the Court of Appeals indicated that the district court should not have focused on the taxpayer’s motivation for not filing a timely FBAR for 2000, and, inasmuch as it did, the district court made an impermissible leap:

In making its determination, the district court emphasized [the taxpayer’s] motivation rather than the relevant issue of his intent. To the extent the district court focused on motivation as proof of the lack of intent, it simply drew an unreasonable inference from the record. In November 2000, Swiss authorities met with [the taxpayer] to discuss the ALQI accounts and thereafter froze them at the request of the United States Government. Although the [U.S.] Government knew of the existence of the accounts, nothing in the record indicates that, when the accounts were frozen, the [U.S.] Government knew the extent, control, or degree of [the taxpayer’s] interest in the accounts or the total funds held in the accounts. As [the taxpayer] admitted in his allocation [at the criminal trial], his decision not to report the accounts was part of his tax evasion scheme that continued until he filed his 2001 tax return. Thus, his failure to disclose information about the ALQI accounts on his 2000 tax return in May 2001 was motivated by his

desire not to admit his interest in the accounts, even after authorities had been aware of them for over six months. Rarely does a person who knows he is under investigation by the [U.S.] Government immediately disclose his wrongdoing because he is not sure how much the [U.S.] Government knows about his role in that wrongdoing. Thus, without question, when [the taxpayer] filed in May of 2001, he was clearly motivated not to admit his interest in the ALQI accounts.⁵⁵

Then, noting various judicial precedents in the *criminal* arena, the Court of Appeals went on to explain what it considered the proper legal standard to be applied. The Court of Appeals explained that: (1) willfulness can be inferred from taxpayer conduct designed to conceal financial information, and (2) willfulness can also be inferred from a taxpayer's conscious effort to avoid learning about reporting requirements, i.e., "willful blindness" exists where a taxpayer knew of a high probability of a tax liability yet intentionally avoided the pertinent facts.⁵⁶ In situations where willfulness is a condition for *civil* liability, the Court of Appeals indicated that this covers both knowing violations and reckless violations of a standard.⁵⁷ It then clarified that the taxpayer's actions or inactions in this case constituted, at a minimum, "reckless conduct, which satisfies the proof requirement [for civil FBAR violations under 31 U.S.C. 5314.]"⁵⁸

Sparing no punches, the Court of Appeals stated that "the evidence as a whole leaves us with a definite and firm conviction that the district court clearly erred in finding that [the taxpayer] did not willfully violate [the FBAR rules for 2000]."⁵⁹ The Court of Appeals supported its decision on the following grounds.

First, the Court of Appeals pointed out that the taxpayer signed his Form 1040 for 2000 under penalties of perjury, thereby swearing that he had examined the Form 1040, as well as all Schedules and Statements attached to such Form 1040, and that all items were true, accurate, and complete. The Court of Appeals then explained that taxpayers who execute a tax return are deemed

to have constructive knowledge of such return, and the taxpayer in this case was no exception to that principle. According to the Court of Appeals, the instructions on Line 7a in Part III of Schedule B to the 2000 Form 1040 (i.e., "see instructions and exceptions and filing requirements for Form TD F 90-22.1") put the taxpayer on inquiry notice of the FBAR duty.⁶⁰ The taxpayer testified that he did not review his 2000 Form 1040 in general or read the information in Schedule B in particular. The Court of Appeals interpreted this inaction as conduct designed to conceal financial information, a conscious effort to avoid learning about reporting requirements, and "willful blindness" to the FBAR requirement.⁶¹

Second, the Court of Appeals held that the taxpayer's allocation at the earlier criminal proceeding further confirms that his failure to file a timely FBAR for 2000 was willful.⁶² Seizing on one tiny portion of the taxpayer's 2003 allocation, the Court of Appeals concluded that the taxpayer admitted his knowledge of the FBAR duty because he used the phrase "Department of the Treasury." This tenuous line of reasoning is as follows:

During that allocation, [the taxpayer] acknowledged that he willfully failed to report the existence of the ALQI accounts to the IRS or Department of the Treasury as part of his larger scheme of tax evasion. This failure to report the ALQI accounts is an admission of violating [the FBAR rules] because a taxpayer complies

with the [FBAR rules] by filing an FBAR with the Department of the Treasury.⁶³

Reasons Why the *Williams* Trilogy Is Interesting

The *Williams* cases were long, fact-intensive, and featured some ambiguous reasoning from the courts. Moreover, as this article demonstrates, *Williams III* turns out to be a groundbreaking case, the first in a line of victories for the government involving civil FBAR penalties. Given the importance of the *Williams* trilogy, a description of the significant (and often overlooked) issues is provided below.

Tax Court Lacks Jurisdiction Over Civil FBAR Matters. In *Williams I*, the taxpayer attempted to dispute not only the tax issues under the Code (i.e., the federal income taxes, accuracy-related penalties, and civil fraud penalties for 1993 through 2000 identified by the IRS in its notice of deficiency), but also the FBAR penalty for 2000 under Title 31 of the U.S. Code. The Tax Court, ruling on this novel issue, held that it lacks authority to hear FBAR issues, both at the assessment stage and the collection stage. Simply put, "[t]he Tax Court has no jurisdiction to review the [IRS's] determination as to [taxpayers'] liability for FBAR penalties."⁶⁴

Appreciating Different Assessment Periods. Although not unduly highlighted in the *Williams* cases, they demonstrate the importance of appre-

NOTES

⁴⁵ *Id.* at pp. 42-43.

⁴⁶ *Id.* at p. 43.

⁴⁷ *Id.* at p. 41.

⁴⁸ *Williams*, note 16, *supra*, Opening Brief for Taxpayer-Appellee, filed 4/28/11, at p. 35.

⁴⁹ *Id.* at p. 35.

⁵⁰ *Id.* at pp. 37-38.

⁵¹ *Id.* at p. 38.

⁵² *Id.* at p. 39.

⁵³ *Id.*

⁵⁴ *Id.* at p. 40. The taxpayer raised some other minor arguments in his Opening Brief, which are not featured in this article.

⁵⁵ *Williams*, note 16, *supra*, at footnote 5.

⁵⁶ *Williams*, note 16, *supra*.

⁵⁷ *Id.*

⁵⁸ *Id.* The Court of Appeals includes, in a footnote, another basis for reversing the district court. It explained that, to the extent that the taxpayer was claiming ignorance of the FBAR filing requirement in connection with reasonable reliance on qualified tax professionals, such ignorance was a result of his own recklessness. This is because the taxpayer never informed his accountant of the existence of the foreign accounts from 1993 to 2000, "even after retaining counsel [in early 2001] and with the knowledge [in November 2000] that the authorities were aware of the existence of the accounts." *Id.* at footnote 6.

⁵⁹ *Williams*, note 16, *supra*.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Williams*, note 14, *supra*.

ciating 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, the IRS faces no time constraints on assessment.⁶⁵ Where FBAR violations are concerned, however, the IRS must assess the penalty within six years of the violation.⁶⁶ Accordingly, while the taxpayer in *Williams* might have “admitted” his noncompliance by filing delinquent FBARs for 1993 through 2000 with the revenue agent in 2007, the IRS was only able to assert an FBAR penalty for one year, 2000, because the six-year statute had already expired for the preceding years.

Reasonable Reliance on Qualified Tax Professionals. 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 a questionnaire/organizer each year, which specifically asked whether he had an interest in or authority over a foreign account. The taxpayer completed it for 2000, affirmatively checking the “no” box to the foreign-account inquiry.⁶⁷ 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 district court did not address the reliance issue in its decision in *Williams II*, centering the discussion instead on the taxpayer’s motives and the distinction between not reporting income on Forms 1040 and not reporting foreign accounts on FBARs. The Court of Appeals, however, made short order of the reliance defense in *Williams III*, underscoring the following:

[T]o the extent [the taxpayer] asserts he was unaware of the FBAR require-

ment because his attorneys or accountants never informed him, his ignorance also resulted from his own recklessness. [The taxpayer] concedes that from 1993-2000 he never informed his accountant of the existence of the foreign account after retaining counsel and with the knowledge that authorities were aware of the existence of the accounts.⁶⁸

Questioning the Amount of the FBAR Penalty. The scope of FBAR “collection actions” was examined and clarified in *Williams II*. The parties had divergent opinions on the district court’s role. On one hand, the government argued that the *amount* of the FBAR penalty asserted by the IRS is not subject to judicial review, and that there is no authority for the proposition that a district court, hearing a “collection action” under 31 USC section 5321(b)(2), can review the IRS’s administrative record or the factors considered by the IRS in determining the penalty. 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.”⁶⁹ In other words, the government maintained that the district court’s sole job is to determine whether a taxpayer “willfully” failed to file the FBAR.

The taxpayer, on the other hand, repeatedly argued that the court had the 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.⁷⁰

Because the district court held that the taxpayer did not “willfully” fail to file the FBAR and no penalties were sustained, this issue was not specifically addressed in *Williams II*. Moreover, the taxpayer did not renew this issue in *Williams III*. This issue, therefore, went unresolved.

Assessing the Weight of Unpublished Decisions. *Williams III*, as the first decision by a federal Court of Appeals to wrangle with tricky civil FBAR issues, is important. However, it was issued as an “unpublished” opinion, expressly noting in the decision itself that “[u]npublished opinions are not binding precedent in this circuit.” Many taxpayers and practitioners would like nothing better than to ignore or demote the case on this basis, but doing so would be imprudent. This is because the potential use and value of “unpublished” decisions is surprisingly broad.

Federal Rules of Appellate Procedure Rule 32.1(a) generally provides that a court may not prohibit or restrict the citation of federal judicial opinions, orders, judgments, or other written dispositions that have been designated as “unpublished,” “not for publication,” “non-precedential,” “not precedent,” or the like. Moreover, the Advisory Committee Notes to Rule 32.1 state the following:

Rule 32.1 is extremely limited. It does not require any court to issue an unpublished opinion or forbid any court from doing so. It does not dictate the circumstances under which a court may choose to designate an opinion as “unpublished” or specify the procedure that a court must follow in making that determination. It says nothing about what effect a court must give to one of its unpublished opinions or to the unpublished opinions of another court. . . . Under Rule 32.1(a), a court of appeals may not prohibit a party from citing an unpublished opinion of a federal court for its persuasive value or for any other reason. In addition, under Rule 32.1(a), a court may not place any restriction on the citation of such opinions. For example, a court may not instruct parties that the citation of unpublished opinions is discouraged, nor may a court forbid parties to cite unpublished opinions when a published opinion addresses the same issue.

The preceding procedural rule and related commentary create ambiguity regarding how much weight *Williams III* will carry in the future. One thing is for sure, though, as the IRS continues

to assert large civil FBAR penalties, and as taxpayers keep challenging such penalties, the U.S. government will be citing *Williams III* often.

Varying Interpretations of Willfulness. Other cases have previously addressed the concept of “willfulness” in the context of criminal issues, including criminal FBAR violations. Those cases stand for the proposition that willfulness means a “voluntary, intentional violation of a known legal duty.”⁷¹ *Williams II* and *III* are important because they are the first in which the courts have interpreted the concept of “willfulness” in the civil FBAR context.

The Court of Appeals in *Williams III* indicated that the taxpayer’s conduct (i.e., checking the “no” box in response to the foreign-account question on Schedule B to his Form 1040 for 2000, not reviewing the Schedule B or its cross-references to the FBAR filing requirement, etc.) constituted “reckless conduct” and “willful blindness” to his FBAR duty. Interestingly, the legal standard applied by the Court of Appeals in *Williams III* is significantly lower than that previously indicated by the IRS. In other words, even the IRS initially believed that it had to reach a much higher level in order to successfully assert and collect a civil FBAR willful penalty. This is evident from the following IRS materials.⁷²

The IRS issued a legal memorandum in 2006, CCA 200603026, in connection with two of its international enforcement programs. One of the issues addressed was the proper interpretation of the “willfulness” standard in the context of civil FBAR penalties. The IRS’s directness on this point was remarkable: “The first question is whether the phrase ‘willful violation (or willfully causes any violation)’ has the same definition and interpretation under 31 U.S.C. § 5321 (the civil penalty) and § 5322 (the criminal penalty). *The answer is yes.*” Lest any doubt remain, CCA 200603026 goes on to state the following:

Both Section 5321(a)(5), providing for a civil penalty, and Section 5322(a), providing for criminal

penalties, contain a similar “willfulness” requirement. . . . The same word, willful, is used in both of these sections. Statutory construction rules would suggest that the same word used in related sections should be consistently construed.

In referring to a dissenting opinion in the Supreme Court case *Ratzlaf*, the IRS then explained the following in CCA 200603026:

[W]e agree with his conclusion that in the case of the FBAR penalty, in order for there to be a voluntary intentional violation of a known legal duty, the account holder would just have to have knowledge that he had a duty to file an FBAR, since knowledge of the duty to file an FBAR would entail knowledge that it is illegal not to file the FBAR. A corollary of this principle is that there is no willfulness if the account holder has no knowledge of the duty to file the FBAR.

Similar to CCA 200603026, the IRS acknowledges in the Internal Revenue Manual (IRM) that, in the context of willful FBAR penalties, the test is whether “there was a voluntary, intentional violation of a known legal duty” and “willfulness is shown by the person’s knowledge of the [FBAR] reporting requirements and the person’s conscious choice not to comply with the requirements.”⁷³

Second Case Addressing “Willful” FBAR Civil Penalties: *McBride*

Williams III sparked much controversy and confusion, but the debate over its significance did not last long because the second case addressing civil “willful” FBAR penalties, *McBride*,⁷⁴ was decided less than four months later by a district court in Utah.

The Key Facts⁷⁵

Mr. McBride, a U.S. citizen, was a partner in a domestic partnership called the Clip Company, LLC, which sold accessories that allowed people to carry mobile phones on their belts. Mr. McBride was in charge of the financial operations of the Clip Company. As with many modern products, the phone accessories were not made in the U.S.; they were produced by an outfit in Tawain (Taiwanese Manufacturer).

Starting in 1999, the Clip Company entered into various lucrative contracts for the sale of its belt accessories to major mobile phone producers and retailers, including Ericsson, AT&T, Best Buy, and Motorola. Mr. McBride anticipated that a significant increase in revenue (approximately \$2 million) would result from such contracts, so he began seeking ways to reduce or defer taxes that he, as half-owner of the

NOTES

⁶⁵ Sections 6501(c) (1) and (2).

⁶⁶ 31 USC section 5321(b)(1).

⁶⁷ *Williams*, note 15, *supra*, U.S. Proposed Findings of Fact and Conclusions of Law filed 4/26/10; U.S. Post-Trial Brief filed 7/1/10, at p. 10.

⁶⁸ *Williams*, note 16, *supra*, at footnote 6.

⁶⁹ *Williams*, note 15 *supra*, U.S.’s Post-Trial Brief, filed 7/1/10, at p. 14.

⁷⁰ *Williams, Id.*, Defendant Williams’ Response to Government’s Post-Trial Brief, filed 7/15/10, at pp. 8-10.

⁷¹ *Cheek*, 498 U.S. 192, 67 AFTR2d 91-344 201 (1991); *Sturman*, 951 F.2d 1466, 1476 (CA-6, 1991); *Bishop*, 412 U.S. 346 AFTR2d 73-5018, 360 (1973).

⁷² Several articles explain how the legal standard for “willfulness” developed by the Court of Appeals in *Williams III* would not only conflict with published guidance from the IRS on the civil FBAR issue, but also with various court decisions. See, e.g., Skarlatos and Sardar, “The Fourth Circuit Goes Too Far by Imposing a Willful FBAR Penalty on Reckless Conduct in the *Williams Case*,” 14(4) *Journal of Tax Practice & Procedure* 9-12 (2012); Sardar, “What Consti-

tutes ‘Willfulness’ for Purposes of the FBAR Failure-to-File Penalty?” 113 JTAX 183 (September 2010).

⁷³ IRM section 4.26.16.4.5.3 (7/1/08); IRM section 4.26.16.6.5.1 (11/6/15).

⁷⁴ 908 F.Supp.2d 1186, 110 AFTR2d 2012-6600 (DC Utah, 2012), Findings of Fact, Conclusions of Law, and Order.

⁷⁵ The facts, analysis, and holdings were derived primarily from *McBride*, note 74, *supra*. The author also obtained and reviewed the following materials filed by the parties, which provided additional data: (1) Complaint, 4/29/09; (2) Answer, 6/18/09; (3) Plaintiff’s Motion for Summary Judgment, 10/15/10; (4) Defendant’s Memorandum in Opposition of Plaintiff’s Motion for Summary Judgment; (5) Plaintiff’s Reply to Defendant’s Opposition to Motion for Summary Judgment; (6) Order Denying Motion for Summary Judgment, 2/24/11; (7) Notice of Supplemental Authority by Plaintiff, 5/13/11; (8) Plaintiff’s Trial Brief, 5/14/12; (9) Defendant’s Trial Brief, 5/14/12; (10) Transcript of Bench Trial Volumes I and II, 7/2/12; (11) Plaintiff’s Proposed Findings of Fact, 7/23/12; and (12) Defendant’s Proposed Findings of Facts, 8/2/12.

Clip Company, would normally be required to pay. This effort led him in 1999 to Merrill Scott and Associates (MSA), whose operations he had seen advertised.

MSA portrayed itself as a financial management firm that allowed its clients to achieve two main goals, tax minimization and asset protection. Mr. McBride went to the offices of MSA in July 1999, where he was treated to a presentation about a potential strategy. MSA labeled the strategy the “Financial Master Plan.” With respect to the goal of tax minimization, the promotional materials from MSA: (1) suggested the creation of a

accounts. U.S. citizens and others filing Internal Revenue Service returns are not immune from requisite declaration of ownership interests in foreign entities.” The pamphlet also contained this warning: “As a U.S. taxpayer, the law requires you to report your financial interest in, or signature authority over, any foreign bank account, securities account, or other financial account [and] intentional failure to comply with the foreign account reporting rule is a crime and the IRS has means to discover such unreported assets.” In addition to the pamphlets, the folks at MSA also gave Mr. McBride a written legal opinion about the Financial Master Plan. The opinion

cordingly, what follows is a good-faith description of the major aspects of the Financial Master Plan, including the main entities and money flow.

Pursuant to the Financial Master Plan, MSA either formed or made available to Mr. McBride two foreign entities: Drehpunkt Ltd. (Foreign Entity One) and Lombard & Associates, Ltd. (Foreign Entity Two).⁷⁶ These entities were controlled, at least nominally, by individuals who were either employed by or otherwise associated with MSA. Separate accounts were then opened at the Royal Bank of Scotland, in the Bahamas, for Foreign Entity One and Foreign Entity Two. MSA also established two additional entities, in Canada, at the request of Mr. McBride, Phoenix Overseas Advisors, Ltd. (Foreign Entity Three) and Global Securities Corporation (Foreign Entity Four). Foreign brokerage accounts were then opened under each of these two Canadian entities to enable Mr. McBride to engage in securities transactions.

Also pursuant to the Financial Master Plan, Mr. McBride, through the Clip Company, entered into an agreement with the Taiwanese Manufacturer, whereby the Clip Company would pay the Taiwanese Manufacturer an inflated price for the phone accessories. This deliberate overpayment (which the Clip Company likely treated as a component of cost-of-goods-sold) would result in “excess funds” for the Taiwanese Manufacturer, which would normally have been treated as taxable profits to the Clip Company. The Taiwanese Manufacturer then sent the “excess funds” by wire transfer to the Bahamian account of Foreign Entity One. It is unclear whether the Taiwanese Manufacturer received a fee for this accommodation.

Let us take a simplified, hypothetical example to see how this might have functioned. If the Taiwanese Manufacturer produced and sold each phone accessory to the Clip Company for \$10, and the Clip Company, in turn, could sell each accessory to the ultimate consumer for \$30. This would normally render a taxable profit for the Clip Company of \$20 per accessory. However, if the Taiwanese Manufacturer

“decontrolled” environment, achieved through the use of sophisticated financial instruments, foreign entities, and foreign accounts; (2) stated that certain foreign entities “will be used as vehicles to capture business income offshore and U.S. tax-free;” (3) explained that certain funds sent to a foreign manufacturer would be “captured offshore in [a foreign entity] allowing for tax-free growth and accumulation;” and (4) “by redirecting taxable income into various expense centers, you are able to save on net taxes.” Apparently, after hearing the pitch about the Financial Master Plan, Mr. McBride announced his initial impression that it was tantamount to “tax evasion.” The representatives of MSA, of course, refuted his claims and assured him that the Financial Master Plan was legal.

During the meeting in 1999, the MSA representatives gave Mr. McBride several pamphlets describing the Financial Master Plan, including how it affected U.S. tax and reporting duties. One of the pamphlets stated the following: “U.S. citizens are subject to specific U.S. reporting requirements for interests in foreign corporations, trusts and bank

was prepared by the Estate Planning Institute, P.C., which Mr. McBride learned within a week of the meeting in July 1999 was an entity controlled by or related to MSA.

Mr. McBride entered into a “implementation agreement” with MSA in July 1999, whereby he purchased the Financial Master Plan for \$75,000 and obligated himself to pay additional monthly fees for ongoing services from MSA. The memo field of the checks that Mr. McBride used to make the initial payment to MSA indicated that the purpose of the payments was “[b]ank account offshore.”

In August 1999, Craig Taylor (Accountant Taylor), the accountant for Mr. McBride’s business partner, sent Mr. McBride a memo expressing certain concerns about the Financial Master Plan and enclosing a newspaper article explaining that holding foreign bank accounts was often associated with tax evasion and fraudulent activity. This did not dissuade Mr. McBride from proceeding.

The Financial Master Plan was convoluted, presumably by design, and the factual findings by the district court left various aspects rather ambiguous. Ac-



Williams II and III are important because they are the first in which the courts have interpreted the concept of “willfulness” in the civil FBAR context.

raised its price to \$20 per accessory, the Clip Company would show a taxable profit of only \$10 per accessory. The key is what happens to the extra \$10 per accessory, i.e., the “excess funds” on which the IRS focused.

The next step was to get the untaxed “excess funds” back to Mr. McBride and/or the Clip Company. This was accomplished in multiple ways, including, but not limited to, the use of a “loan” arrangement. Apparently, funds were transferred from the Bahamian account of Foreign Entity One to another foreign company controlled by MSA. Then, this company purportedly made a “loan” to the Clip Company in the form of a line-of-credit. According to the district court, this essentially allowed the Clip Company to “borrow” its own (untaxed) money. Whenever the Clip Company reached its credit limit, MSA, through the foreign company, would simply raise the limit and honor all additional requests for funds by Mr. McBride. The district court indicated that Mr. McBride instructed MSA on how, when, and where to transfer funds.

Once the untaxed funds had been repatriated, either through the “loan” arrangement or otherwise, they were used for a variety of purposes. For example, they were used for the payment of regular business expenses for the Clip Company, distributions in the form of “partner draws” to Mr. McBride, mortgage payments for Mr. McBride’s former wife, the purchase of Christmas presents for Mr. McBride’s parents, airline travel, automobile leases, investments in various entities, and satisfaction of outstanding legal fees.

In early 2001, Mr. McBride stopped receiving status reports from MSA about the foreign assets and interest payments made on the line-of-credit. This halt of information triggered Mr. McBride’s concern about the legitimacy of MSA. Therefore, in an attempt to recoup his funds, Mr. McBride persuaded MSA in March 2001 to further increase the line-of-credit for the Clip Company by \$665,000 and then immediately withdrew all such funds.

Let us talk numbers. During 2000 and 2001, approximately \$2.7 million

of otherwise taxable business profits to the Clip Company were ultimately routed to Mr. McBride. The highest balances in the unreported foreign accounts are relevant, too. The district court, looking to the documentation presented by the U.S. Department of Justice, determined that in both 2000 and 2001, Mr. McBride had a reportable interest in four accounts whose balances ranged from \$10,900 to \$736,902.

With respect to his Form 1040 for 2000, Mr. McBride worked with Craig Stayner (Accountant Stayner), who also served as the accountant for the Clip Company. Mr. McBride never discussed with Accountant Stayner his involvement with MSA, provided him with any documentation related to MSA, or mentioned that Accountant Taylor might have some information or expertise regarding the Financial Master Plan and international tax and reporting obligations. Part III to Schedule B of Mr. McBride’s Form 1040 for 2000 had the “no” box checked in response to the question about the existence of foreign accounts, and McBride did not file an FBAR for 2000 with the Treasury Department by the 6/30/01 deadline. Of course, Mr. McBride signed and dated his Form 1040, thereby declaring under penalties of perjury that he had examined the Form 1040, as well as all accompanying Schedules and Statements, and, to the best of his knowledge, everything was true, correct, and complete.

Mr. McBride made a switch the next year, shifting his tax-related work to Accountant Taylor. His representative may have changed, but his actions did not: Mr. McBride checked the “no” box in Part III of Schedule B, thereby denying that he had a reportable interest in any foreign account, he neglected to file an FBAR for 2001 with the Treasury Department by 6/30/02, and he signed and dated his Form 1040, again swearing that he had reviewed and approved the entire Form 1040 for 2002, including all Schedules and Statements.

The IRS began examining Mr. McBride in 2004 for potential noncompliance issues related to his participation in the Financial Master Plan. He adopted a defensive position, refusing to provide

certain documents to the revenue agent, denying that he had used the Financial Master Plan, professing ignorance of wire transfers from the foreign accounts of Foreign Entity One and Foreign Entity Two, claiming that the line-of-credit to the Clip Company was a legitimate loan, and refusing to complete and submit FBARs for 2000 and 2001. The revenue agent eventually asserted a civil FBAR penalty for each of 2000 and 2001 “in the amount of \$100,000 (\$25,000 per account) for his willful failure to report his interest in the foreign accounts.”⁷⁶ In other words, the revenue agent asserted a total “willful” FBAR penalty of \$200,000, i.e., \$100,000 for each year, which he presumably believed was the maximum penalty allowed under the law applicable to those two years.

The District Court’s Holding

Burden of Proof in Civil FBAR Collection Cases. The district court in *McBride* began its analysis by addressing the burden of proof issue. It explained that the relevant statute, 31 USC section 5321(b)(2), simply allows the U.S. government to “commence a civil action to recover a civil penalty assessed” under the relevant FBAR provisions, but does not specify the legal standard that applies. The district court then pointed out that only one federal court has directly spoken to this issue, i.e., the district court in *Williams II*. There, it was determined that the government’s burden of proof is “the preponderance of the evidence” on all issues, including the issue of whether a taxpayer’s failure to file an FBAR was “willful.” Wrapping itself in the logic of *Williams II*, the district court in *McBride* reasoned as follows:

The preponderance of the evidence standard applied by the district court in [*Williams II*] is the correct stan-

NOTES

⁷⁶ The materials filed with or issued by the district court in *McBride* indicate that another entity in the Bahamas, Palisades & Associates, Ltd., was formed or made available to Mr. McBride. It appears that no foreign accounts were opened under such entity and it was not otherwise pivotal to the case. Accordingly, Palisades & Associates Ltd. is not further addressed in this article.

⁷⁷ *McBride*, note 74, *supra*, Slip Opinion, at p. 24.

dard. As with Government penalty enforcement and collection cases generally, absent a statute that prescribes the burden of proof, imposition of a higher burden of proof is warranted only where ‘particularly important individual interests or rights’ are at stake. Because the FBAR penalties at issue in this case only involve money, it does not involve ‘particularly important individual interests or rights’ as that phrase is used in [the relevant cases].⁷⁸

Analysis of the Willfulness Issue. With the burden of proof issue resolved, the district court turned to the elements that the U.S. government must establish in order to collect a “willful” FBAR penalty. The majority of the elements were undisputed, leaving the focus squarely on the question of whether Mr. McBride had “willfully” failed to file FBARs for 2000 and 2001. Indeed, 18 pages of the district court’s 25-page legal analysis were devoted solely to the “willfulness” issue. Breaking this into digestible pieces is thus required.

Standard for Determining Willfulness in Civil FBAR Cases. Adhering to a line of reasoning presented earlier by the Fourth Circuit Court of Appeals in *Williams III*, the district court indicated that “willfulness” in this context includes not only knowing FBAR violations, but also reckless ones.⁷⁹ The district court, citing to precedent from the Supreme Court as well as *Williams III*, then explained that “willful blindness” satisfies the willfulness standard in both criminal and civil contexts.⁸⁰ Finally, the district court noted that willful intent can be proven by circumstantial evidence, and reasonable inferences can be drawn from the facts because direct proof of a taxpayer’s intent is rarely available.⁸¹

Taxpayer Had Constructive Knowledge of the FBAR Requirement. The district court next turned to Mr. McBride’s level of knowledge of the FBAR filing requirement. Its ultimate conclusion on this issue is remarkably clear, but the district court’s analysis meandered somewhat. The court cited the general rule that all taxpayers are charged with knowledge, awareness, and responsibility for all tax returns executed under

penalties of perjury and filed with the IRS. It then underscored that the only case thus far to examine willfulness in the context of civil FBAR penalties is *Williams III* and summarized the government-favorable holdings in that case. Next, the court recognized that several cases stand for the proposition that the taxpayer’s signature on a tax return does not, by itself, prove that the taxpayer had knowledge of the contents of the return. The district court distinguished such cases, though, by emphasizing that the language therein about “knowledge of the contents of the return” refers to the taxpayer’s awareness about specific figures on the return. When dealing with the FBAR situation, the court pointed out that “knowledge of what instructions are contained within the form is directly inferable from the contents of the form itself, even if it were blank.”⁸² Fortifying its position, the district court went on to cite and quote various criminal cases, including a criminal FBAR case, where the courts attributed to the taxpayer knowledge of the contents of a return based solely on the taxpayer’s signature on the tax return.⁸³ The court, eliminating any ambiguity about its stance on constructive knowledge, rendered the following holding:

Knowledge of the law, including knowledge of the FBAR requirements, is imputed to McBride. The knowledge of the law regarding the requirement to file an FBAR is sufficient to inform McBride that he had a duty to file [an FBAR] for any foreign account in which he had a financial interest. McBride signed his federal income tax returns for both the tax year 2000 and 2001. Accordingly, McBride is charged with having reviewed his tax return and having understood that the federal income tax return asked if at any time during the tax year he held any financial interest in a foreign bank or financial account. The federal income tax return contained a plain instruction informing individuals that they have the duty to report their interest in any foreign financial or bank accounts held during the taxable year. McBride is therefore charged with having had knowledge of the FBAR requirement to disclose his interest in any foreign financial or bank accounts,

as evidenced by his statement at the time he signed the returns, under penalty of perjury, that he read, reviewed, and signed his own federal income tax returns for the tax years 2000 and 2001, as indicated by his signature on the federal income tax returns for both 2000 and 2001. As a result, McBride’s willfulness is supported by evidence of his false statements on his tax returns for both the 2000 and the 2001 tax years, and his signature, under penalty of perjury, that those statements were complete and accurate.⁸⁴

Taxpayer Had Actual Knowledge of the FBAR Requirement. More importantly, explained the district court, Mr. McBride had actual knowledge of the FBAR filing requirement. The court identified four items in support of this determination. First, Mr. McBride read the pamphlets and other promotional material provided by MSA, which explained the duty to report an interest in foreign financial accounts. Second, Mr. McBride testified at trial that the purpose of adopting the Financial Master Plan was to avoid disclosure of certain assets and the payment of taxes thereon. Third, Mr. McBride engaged in an evasive course of conduct with the revenue agent during the audit, lying about certain facts and withholding information and documentation. Finally, Mr. McBride made statements at trial that contradicted his earlier sworn statements during the discovery phase of the trial.

Taxpayer Acted with Reckless Disregard or Willful Blindness. The district court identified a long list of items that, together, supposedly demonstrated that Mr. McBride either willfully or recklessly disregarded the obvious risk of tax-related problems (including FBAR violations) because of his participation in the Financial Master Plan. These items included the following: (1) Mr. McBride reviewed the memo and enclosed newspaper article from Accountant Taylor in August 1999 expressing concern about the validity of the Financial Master Plan; (2) Mr. McBride was already concerned about MSA in March 2001, well before he filed his Form 1040 for 2000; (3) Mr. McBride

knew that the purpose of the Financial Master Plan was to avoid taxation and certain reporting requirements; (4) Mr. McBride knew the Financial Master Plan involved the use of foreign entities held by nominees; (5) Mr. McBride's initial impression of the Financial Master Plan was that it constituted "tax evasion;" (6) Mr. McBride did not seek a legal opinion or guidance from outside, independent counsel; (7) Part III of Schedule B to Form 1040 contained a "plain instruction" regarding disclosure of foreign accounts; and (8) Mr. McBride did not discuss with or provide information to either of his two accountants regarding the Financial Master Plan.⁸⁵

Reason Why *McBride* Is Interesting. The obvious reason that *McBride* is noteworthy is that it constitutes only the second case to wrangle with novel legal issues related to the collection of "willful" FBAR penalties. Another apparent reason is that it followed, to a certain degree, the government-favorable holding in *Williams III* that a taxpayer's constructive knowledge of the FBAR filing requirement suffices to prove willfulness. There are several more obscure reasons why *McBride* is significant, too. Some of these reasons, which likely went unnoticed by many taxpayers and practitioners, are examined below.

Government Reverses Course on Burden of Proof. As explained above, the district court in *McBride*, adhering to the judicial reasoning in *Williams II*, held that the proper legal standard in FBAR collection cases is preponderance of the evidence, because the relevant statute is silent on the issue and because the civil FBAR penalty only involves money, not "important individual interests or rights."⁸⁶ *McBride* is noteworthy because it shows (to those who are paying close attention) how the IRS has radically changed its position on this issue since the courts started rendering unexpected, helpful decisions.

In 2006, the IRS issued a legal memorandum on offshore issues, covering several items, including the burden on

the IRS in civil FBAR penalties. This was the infamous CCA 200603026. The IRS's position at that time, looking into the proverbial crystal ball, was that the courts would obligate the IRS to reach a tougher threshold, clear and convincing evidence.

We expect that a court will find the burden in civil FBAR cases to be that of providing "clear and convincing evidence," rather than merely a "preponderance of the evidence." The clear and convincing evidence standard is the same burden the [IRS] must meet with respect to civil tax fraud cases where the [IRS] also has to show the intent of the taxpayer at the time of the violation. Courts have traditionally applied the clear and convincing standard with respect to fraud cases in general, not just to tax fraud cases, because, just as it is difficult to show intent, it is also difficult to show a lack of intent. The higher standard of clear and convincing evidence offers some protection for an individual who may be wrongly accused of fraud . . . Because the FBAR penalty is not a tax or a tax penalty, the presumption of correctness with respect to tax assessments would not apply to an FBAR penalty assessment for a willful violation another reason we believe that the [IRS] will need to meet the higher standard of clear and convincing evidence.⁸⁷

It is interesting to witness the IRS's shift of position on the burden of proof issue during *McBride*. The government attorneys, anticipating that counsel for Mr. McBride might point to the IRS's legal memorandum cited above, essentially explained to the district court on brief that the IRS's position back in 2006 was wrong and it should be ignored altogether. The following shows more accurately how the IRS tried to distance itself from its earlier analysis:

NOTES

⁷⁸ *McBride*, note 74, *supra*, Slip Opinion, at p. 27 (internal citations omitted).
⁷⁹ *McBride*, note 74, *supra*, Slip Opinion, at p. 32.
⁸⁰ *McBride*, note 74, *supra*, Slip Opinion, at pp. 32-33.
⁸¹ *McBride*, note 74, *supra*, Slip Opinion, at p. 33.
⁸² *McBride*, note 74, *supra*, Slip Opinion, at pp. 36-37.
⁸³ *McBride*, note 74, *supra*, Slip Opinion, at pp. 37-38.
⁸⁴ *McBride*, note 74, *supra*, Slip Opinion, at pp. 38-39 (internal citations omitted).
⁸⁵ *McBride*, note 74, *supra*, Slip Opinion, at pp. 42-49.

Though McBride may attempt to assert that the applicable burden of proof with respect to the issue of willfulness is the 'clear and convincing standard,' that assertion is wrong and unsupported by any law. Moreover, McBride may not cite to Internal Revenue Service Legal Memorandum [because] 26 U.S.C. § 6110 specifically prohibits Chief Counsel Advice memoranda like the one mentioned by counsel for McBride from being either used or cited as precedent. Therefore, that memorandum has no controlling effect, and moreover should not have any persuasive value . . .⁸⁸

It is equally interesting to see the IRS attempt to put a final spin on the burden of proof debate after the IRS-favorable holdings in *Williams II* and *McBride*. High-ranking IRS attorneys at the forefront of all things FBAR stated, in early 2013, that the issue has been resolved, at least from their perspective.

[T]he IRS office of Chief Counsel initially took a conservative position when it advised field agents on the standard of proof the government must satisfy to show willfulness for the FBAR penalty, in part because the issue had not been litigated. But the courts have since agreed with the IRS that preponderance of the evidence, rather than clear and convincing evidence, is the correct standard to apply in the civil [FBAR] context.⁸⁹

Confusion Created About the Reasonable Reliance Defense. Most taxpayers facing tax adjustments and/or penalties often look outward to justify their transgressions, and Mr. McBride was no different. He maintained that he reasonably relied on three different persons, such that FBAR penalties should be mitigated.

Mr. McBride began by arguing that he reasonably relied on Accountant

⁸⁶ *McBride*, note 74, *supra*, Slip Opinion, at p. 27 (internal citations omitted).
⁸⁷ "Service Discusses Foreign Bank and Financial Accounts Report Penalty," 2006 *Tax Notes Today*, Doc. 2006-1196 (2/10/06); CCA 200603026.
⁸⁸ *McBride*, note 74, *supra*, Plaintiff's Trial Brief, 5/14/12, pp. 8-9.
⁸⁹ Coder, "Taxpayers Face Hurdles and Risks When Opting-Out of U.S. Offshore Voluntary Disclosure Program," 2013 *Worldwide Tax Daily* 12-4 (1/17/13).
⁹⁰ *McBride*, note 74, *supra*, Slip Opinion, at pp. 45-46.

Stayner with respect to his Form 1040 for 2000. The district court quickly dispensed with this argument because Mr. McBride did not fully inform Accountant Stayner about his involvement with MSA and the Financial Master Plan.⁹⁰ This ruling raises no concerns.

Mr. McBride then contended that he relied on MSA and its attorneys,

the tax due. This duty generally cannot be avoided by relying on an agent. McBride knew, or at least made himself willfully blind, about the need to report his interests in the foreign accounts when he signed his 2000 return. That [Accountant] Taylor may have further facilitated McBride's willful blindness a year later [in 2001] by failing to dispense

... it is reasonable for the taxpayer to rely on that advice" and further acknowledging that "[m]ost taxpayers are not competent to discern error in the substantive advice of an accountant or attorney."⁹⁵

Second, in stating that Mr. McBride could not rely on others to file a return and pay the proper tax, the district court seems to blur the long line of tax cases distinguishing between reliance on tax advice (which can constitute "reasonable cause") and reliance on others to perform non-delegable ministerial tasks (which cannot constitute "reasonable cause").⁹⁶ The Tax Court has previously explained this distinction, which seemed to escape the district court in *McBride*:

In general, a taxpayer's duty to file a return when due is a personal, non-delegable duty. Thus, reliance upon an accountant to file is ordinarily no excuse for filing a return beyond the due date. However, the Supreme Court has distinguished between the case in which a taxpayer reasonably relies on the substantive tax advice of an accountant or attorney that no return need be filed . . . Similarly, this Court has held that reasonable cause . . . can be shown by proof that the taxpayer supplied all relevant information to a competent tax adviser and relied in good faith on the incorrect advice of the adviser that no return was required to be filed.⁹⁷

Edging Toward Strict Liability. The *McBride* case is also interesting because of the district court's broad interpretation of "willfulness" in the FBAR context, which seemingly pushes the concept toward one of strict liability. Although not entirely clear, it appears that Mr. McBride argued that he was aware of the FBAR filing requirement, but decided not to comply because of his belief, based to a certain extent on the analysis of Accountant Taylor, that he did not possess a sufficient interest in the foreign accounts under the peculiar FBAR attribution rules. As the culmination to its 18-page analysis of the "willfulness" issue, the district court effectively concluded that, if a taxpayer executes and files his Form 1040, then all failures to file FBARs, regardless of the validity of the taxpayer's rationale



The obvious reason that *McBride* is noteworthy is that it constitutes only the second case to wrangle with novel legal issues related to the collection of "willful" FBAR penalties.

presumably the ones that prepared the legal opinion about the Financial Master Plan. The district court also swiftly rejected this position because such advisors lacked the necessary independence.⁹¹ This ruling does not cause any concerns either.

Lastly, Mr. McBride maintained that he relied on Accountant Taylor with respect to his Form 1040 for 2001. As explained earlier, the district court found that Accountant Taylor sent Mr. McBride in August 1999 a memo expressing concerns about the Financial Master Plan and enclosing an article addressing legal and compliance issues related to foreign bank accounts. The district court came to the following conclusion about the supposed dependence on Accountant Taylor:

Even if [Accountant] Taylor was fully aware of the [MSA] scheme yet failed to properly advise McBride to report his interests in the foreign accounts, this would not excuse McBride. The taxpayer, not the preparer, has the ultimate responsibility to file his or her return and to pay

proper advice does not render McBride's failure to report his interest in the foreign accounts any less willful.⁹²

This holding raises questions for two main reasons. First, the broad opening statement (i.e., that no reasonable cause would exist even if Accountant Taylor were "fully aware" of the offshore issues and failed to properly advise Mr. McBride) seems inconsistent with well-established law. The regulations recognize that a taxpayer's reasonable reliance on an independent, informed, qualified tax professional often reaches the level of reasonable cause.⁹³ For purposes of the reasonable-reliance defense, the regulations also broadly define the concept of "advice" to cover "any communication" from a qualified advisor and clarify that "[a]dvice does not have to be in any particular form."⁹⁴ The Supreme Court, for its part, has concluded that the IRS must liberally construe the reliance defense, stating that "[w]hen an accountant or attorney advises a taxpayer on a matter of tax law

NOTES

⁹¹ *McBride*, note 74, *supra*, Slip Opinion, at p. 47.

⁹² *McBride*, note 74, *supra*, Slip Opinion, at p. 48 (internal citations omitted).

⁹³ Reg. 1.6664-4(c)(1).

⁹⁴ Reg. 1.6664-4(c)(2).

⁹⁵ *Boyle*, 469 U.S. 241, 55 AFTR2d 85-1535, 251 (1985).

⁹⁶ *McMahan*, 114 F.3d 366, 79 AFTR2d 97-2808 (CA-2, 1997).

⁹⁷ *Zabolotny*, 97 TC 385, 400-401 (1991) (internal citations omitted) (holding that reasonable

cause existed where two CPAs, fully informed of the facts, led the taxpayer to believe that no taxable event was created by the relevant transactions for which any federal excise tax returns would be required to be filed).

⁹⁸ *McBride*, note 74, *supra*, Slip Opinion, at pp. 48-49 (internal citations omitted).

⁹⁹ IRM section 4.26.16.4.5.3 (7/1/08); IRM section 4.26.16.6.5.1 (11/6/15).

¹⁰⁰ IRM section 4.26.16.4.5.3 (7/1/08); IRM section 4.26.16.6.5.1 (11/6/15).

for not filing, are willful and vulnerable to maximum sanctions.

[E]ven if the decision not to disclose McBride's interest in the foreign accounts was based on McBride's belief that he did not hold sufficient interest in those accounts to warrant disclosure, that failure to disclose those interests would constitute willfulness. Because McBride signed his tax returns, he is charged with knowledge of the duty to comply with the FBAR requirements. Whether McBride believed [Accountant] Taylor had determined that a disclosure was not required is irrelevant in light of [the applicable case], which states that the only question is whether the decision not to disclose was voluntary, as opposed to accidental. The government does not dispute that McBride's failure to comply with

FBAR [sic.] was the result of his belief that he did not have a reportable financial interest in the foreign accounts. However . . . the FBAR requirements did require that McBride disclose his interest in the foreign accounts during both the 2000 and 2001 tax years. As a result, McBride's failure to do so was willful.⁹⁸

This final ruling by the district court in *McBride* is noteworthy because it seems contrary to the position taken by the IRS, historically and recently. For instance, in the portion of the Internal Revenue Manual discussing the notion of "willful blindness," the IRS indicates that "[t]he mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blind-

ness."⁹⁹ It goes on to explain that, even in situations where a taxpayer admits knowledge about the FBAR question on Schedule B to Form 1040, willfulness only exists where the taxpayer is incapable of providing the IRS a "reasonable explanation" for not properly responding to the question on Schedule B and not filing an FBAR.¹⁰⁰

Conclusion

The first two willful FBAR penalty cases in which the taxpayer lost, *Williams III* and *McBride*, began to lay the ground work for similar cases. Part two of this article will look at two more such cases, *Bussell* and *Bohanec*. It will also analyze *Bedrosian*, which does not change the existing foundation, but adds three important points. ●

