Litigating the FBAR Penalty—Where Do We Go After IRS Appeals

By Robert Horwitz and Steven Toscher*

Robert Horwitz and Steven Toscher discuss the basis of jurisdiction of the Court of Federal Claims ("CFC") and the Federal District Court over a cause of action for illegal exaction brought by a person who has paid all or a portion of an FBAR penalty assessment and examine the role of the Administrative Procedures Act in challenging an FBAR penalty.

For many years, few practitioners were aware that U.S. persons with foreign accounts were required to file an annual Foreign Bank Account Report ("FBAR") or of the draconian penalties that could be imposed on taxpayers for non-compliance, despite early warnings after the Financial Crimes Enforcement Network ("FinCen") delegated to the IRS responsibility to administer and enforce the FBAR reporting requirements.[1] FBAR penalties are now on the front burner as the IRS has begun wielding the penalty with abandon. IRS agents examining taxpayers who made quiet disclosures or failed to report income from offshore accounts have been told to be "aggressive,"[2] leading to the assertion of one or more 50% willfulness penalties under 31 USC §5321(a)(5)(C).[3]

In too many cases, the IRS Office of Appeals may not be exercising its traditional independent role and has sustained the penalties asserted by revenue agents.[4] This may be a manifestation of the IRS enforcement attitude concerning FBAR penalties, the lack of Appeals history in dealing with the FBAR penalty, limited Appeals resources, or other changes that practitioners have experienced with Appeals over the last few years. Regardless of the current track record, taxpayers should be strongly advised to take advantage of the available administrative appeal with the IRS and consider litigation as a last resort.[5]

Because it is not a Title 26 penalty subject to deficiency procedures, the Tax Court has held it has no jurisdiction over the FBAR penalty.[6] The initial cases involving the FBAR penalty were brought by the Government to reduce the penalty

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to judgment.[7] Recently, however, taxpayers in several cases have decided not to wait for the Government to bring a suit and instead have filed suit challenging FBAR penalties, in some instances asserting that imposition of the penalty violated the Administrative Procedures Act.[8] This article will discuss the basis of jurisdiction of the Court of Federal Claims ("CFC") and the Federal District Court under the Tucker Act and the Little Tucker Act, respectively, over a cause of action for illegal exaction brought by a person who has paid all or a portion of an FBAR penalty assessment. It will then discuss the potential role of the Administrative Procedures Act in challenging an FBAR penalty.[9]

Regardless of the current track record, taxpayers should be strongly advised to take advantage of the available administrative appeal with the IRS and consider litigation as a last resort.

Background of the FBAR Civil Penalty

On October 26, 1970, Congress passed the Bank Secrecy Act as P.L. 91-508. A little noticed provision required the filing of reports and the maintenance of records. As codified in 31 USC §5314(a), it states:

(a) Considering the need to avoid impeding or controlling the export or import of monetary instruments and the need to avoid burdening unreasonably a person making a transaction with a foreign financial agency, the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency. The records and reports shall contain the following information in the way and to the extent the Secretary prescribes:
   (1) the identity and address of participants in a transaction or relationship.
   (2) the legal capacity in which a participant is acting.
   (3) the identity of real parties in interest.
   (4) a description of the transaction.

This provision is the statutory authority for the regulations[10] imposing on U.S. persons with foreign accounts totaling over $10,000 the duty to file annually FinCen Report 114 (formerly Form T.D. 90-22.1), the FBAR.[11]

Initially, there were no civil penalties for failure to comply with §5314(a) and the regulations promulgated under that section. In 1986, Congress added subsection (a)(5) to 31 USC §5321.[12] As originally enacted, §5321(a)(5) authorized the imposition of a penalty for a willful violation of §5314. The maximum penalty for failing to file a report was the greater of the balance in the account at the time of the violation (not to exceed $100,000) or $25,000.

In 1992, the Department of Treasury issued Treasury Directive 15-41, which delegated to the IRS the authority to investigate (but not enforce) potential violations of §5314(a). For the first 10 years after the Directive, enforcement was lax. In its 2002 Report to Congress under §361(b) of the USA Patriot Act, the Treasury Department reported that between 1993 and 2002, the IRS had referred only 12 cases to FinCen to determine whether to impose a civil penalty under §5321(a)(5). Only two penalties were imposed. In four of the cases, FinCen issued warning letters. It took no action in the remaining six cases.[13]

In an effort to increase FBAR compliance, in April 2003, the IRS and FinCen entered into a memorandum agreement under which FinCen delegated the authority to enforce the FBAR penalty to the IRS.[14] The American Jobs Creation Act of 2004 amended the penalty provisions of 31 USC §5321(a)(5).[15] As amended, the statute provides for a penalty for a non-willful violation of §5314 of up to $10,000 unless the violation was due to reasonable cause and "the amount of the transaction or the balance in the account at the time of the transaction was properly reported."[16] In the case of a willful violation, the maximum penalty that can be imposed is the greater of $100,000 or 50% of the balance in the account at the time of the violation for "a failure to report the existence of an account or any identifying information required to be provided with respect to an account." There is no reasonable cause exception for a willful violation.[17]

Following the December 2007 guilty plea of Orange County real estate developer Igor Olenicoff for filing a false return,[18] the UBS deferred prosecution agreement,[19] and the IRS's serial offshore voluntary disclosure initiatives, there has been an increased emphasis on imposing both criminal and civil penalties against persons who hide assets in offshore financial accounts. As explained below, while the area of law is still developing and we can expect the Government to fight jurisdiction where it can, a person against whom an FBAR penalty has been assessed can file a complaint in either District Court or the CFC for the return of monies paid toward an FBAR penalty.

The Tucker Act and the Little Tucker Act

There are two prerequisites for a person to maintain an action against the United States. First, the court must have subject matter jurisdiction. Second, there must be a waiver of sovereign immunity. The Tucker Act[20] and the Little Tucker Act[21] give the Court of Federal Claims ("CFC") and the U.S. district courts, respectively, jurisdiction to hear cases for money damages against the Government. The Tucker Act vests the CFC with jurisdiction over:

> ... any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort.[22]

The Little Tucker Act vests the U.S. district courts with jurisdiction over:

> any other civil action or claim against the United States, not exceeding $10,000 in amount, founded either upon the Constitution, or any Act of Congress, or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort ... .[23]

Besides vesting jurisdiction in the CFC and the district courts, the Tucker Act and the Little Tucker Act waive sovereign immunity for claims for money damages against the United States where the claimant can "demonstrate that the source of substantive law he relies upon 'can fairly be interpreted as mandating compensation by the Federal Government for the damage sustained.'"[24] Thus, the question is whether the statutes or regulations upon which the claim is founded "create the substantive rights to monetary damages" against the United States.[25]

The Supreme Court explained the history of the Tucker Act and the Little Tucker Act in *Bormes*[26]:

> Sovereign immunity shields the United States from suit absent a consent to be sued that is "unequivocally expressed." *United States v. Nordic Village, Inc.*, 503 U.S. 30, 33-34 (1992) (quoting *Irwin v. Department of Veterans Affairs*, 498 U.S. 89, 95 (1990); some internal quotation marks omitted). The Little Tucker Act is one statute that unequivocally provides the Federal Government's consent to suit for certain money-damages claims. *United States v. Mitchell*, 463 U.S. 206, 216 (1983) (Mitchell II). Subject to exceptions not relevant here, the Little Tucker Act provides that "district courts shall have original jurisdiction, concurrent with the United States Court of Federal Claims," of a "civil action or claim against the United States, not exceeding $10,000 in amount, founded either upon the Constitution, or any Act of Congress, or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort." 28 U.S.C. §1346(a)(2). The Little Tucker Act and its companion statute, the Tucker Act, §1491(a)(1), do not themselves "creat[e] substantive rights," but "are simply jurisdictional provisions that operate to waive sovereign immunity for claims premised on other sources of law." *United States v. Navajo Nation*, 556 U.S. 287, 290 (2009).
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> The Court of Claims was established, and the Tucker Act enacted, to open a judicial avenue for certain monetary claims against the United States. Before the creation of the Court of Claims in 1855, see Act of Feb. 24, 1855 (1855 Act), ch. 122, §1, 10 Stat. 612, it was not uncommon for statutes to impose monetary obligations on the United States without specifying a means of judicial enforcement. [fn3] As a result, claimants routinely petitioned Congress for private bills to recover money owed by the Federal Government. See *Mitchell II, supra*, at 212 (citing P. Bator, P. Mishkin, D. Shapiro & H. Wechsler, *Hart and Wechsler's The Federal Courts and the Federal System* 98 (2d ed. 1973)). As this individualized legislative process became increasingly burdensome for Congress, the Court of Claims was created "to relieve the pressure on Congress caused by the volume of private bills." *Glidden Co. v. Zdanok*, 370 U.S. 530, 552 (1962) (plurality opinion). The 1855 Act authorized the Court of Claims to hear claims against the United States "founded upon any law of Congress," §1, 10 Stat. 612, and thus allowed claimants to sue the Federal Government for monetary relief premised on other sources of law. (Specialized legislation remained necessary to authorize the payments approved by the Court of Claims until 1863, when Congress empowered the Court to enter final judgments. See Act of Mar. 3, 1863 (1863 Act), ch. 92, 12 Stat. 765; *Mitchell II, supra*, at 212- 214 (recounting the history of the Court of Claims)).

Enacted in 1887, the Tucker Act was the successor statute to the 1855 and 1863 Acts and replaced most of their provisions. See Act of Mar. 3, 1887 (1887 Act), ch. 359, 24 Stat. 505; *Mitchell II, supra*, at 213-214. Like the 1855 Act before it, the Tucker Act provided the Federal Government's consent to suit in the Court of Claims for claims "founded upon … any law of Congress." 1887 Act §1, 24 Stat. 505. Section 2 of the 1887 Act created concurrent jurisdiction in the district courts for claims of up to $1,000. The Tucker Act's jurisdictional grant, and accompanying immunity waiver, supplied the missing ingredient for an action against the United States for the breach of monetary obligations not otherwise judicially enforceable.

If a client is facing potential FBAR penalties, it is essential that the practitioner conduct a thorough investigation in order to develop as compelling a case as possible.

The Supreme Court in *Bormes* held that given the specific statutory scheme for damages contained in the Fair Credit Reporting Act ("FCRA"), the Little Tucker Act did not vest the district court with jurisdiction over a claim for damages against the United States for alleged violations of the FCRA.

The Court of Appeals for the Federal Circuit (like its predecessor, the U.S. Court of Claims) has long recognized two types of non-contract damage claims that are cognizable under the Tucker Act: "that under which the plaintiff has paid money over to the Government, directly or in effect, and seeks return of all or part of that sum, and those demands in which money has not been paid but the plaintiff asserts that he is nevertheless entitled to a payment from the treasury."[27]

In *Testan*,[28] the Supreme Court approved the assertion of Tucker Act jurisdiction in cases where the plaintiff seeks the return of money that was alleged to have been illegally paid to the Government. In rejecting the plaintiffs' claim that they were entitled to an award of back pay due to the Government's failing to reclassify them, the Testan Court stated:

> [T]he Tucker Act is merely jurisdictional, and grant of a right of action must be made with specificity. The respondents do not rest their claims upon a contract; neither do they seek the return of money paid by them to the Government. It follows that the asserted entitlement to money damages depends upon whether any federal statute "can fairly be interpreted as mandating compensation by the Federal Government for the damage sustained." *Eastport S.S. Corp. v. United States*, 178 Ct.Cl. at 607, 372 F.2d at 1009; *Mosca v. United States*, 189 Ct.Cl. 283, 290, 417 F.2d 1382, 1386 (1969), cert. denied, 399 U.S. 911 (1970). We are not ready to tamper with these established principles because it might be thought that they should be responsive to a particular conception of enlightened governmental policy.[29]

The Federal Circuit detailed what is needed for a plaintiff to maintain an illegal exaction claim in *Norman*:[30]

> An "illegal exaction," as that term is generally used, involves money that was "improperly paid, exacted, or taken from the claimant in contravention of the Constitution, a statute, or a regulation." *Eastport S.S. Corp. v. United States*, 178 Ct.Cl. 599, 372 F.2d 1002, 1007 (1967). The classic illegal exaction claim is a tax refund suit alleging that taxes have been improperly collected or withheld by the Government. See, e.g., *City of Alexandria v. United States*, 737 F.2d 1022, 1028 (Fed. Cir. 1984). An illegal exaction involves a deprivation of property without due process of law, in violation of the Due Process Clause of the Fifth Amendment to the Constitution.
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> See, e.g., *Casa de Cambio Comdiv*, 291 F.3d at 1363. The Court of Federal Claims ordinarily lacks jurisdiction over due process claims under the Tucker Act, 28 U.S.C. §1491, see *Murray v. United States*, 817 F.2d 1580, 1582 (Fed. Cir. 1987), but has been held to have jurisdiction over illegal exaction claims "when the exaction is based upon an asserted statutory power." *Aerolineas Argentinas v. United States*, 77 F.3d 1564, 1573 (Fed. Cir. 1996); see also *Eastport*, 372 F.2d at 1008 (Court of Claims had jurisdiction over exaction "based upon a power supposedly conferred by a statute"). To invoke Tucker Act jurisdiction over an illegal exaction claim, a claimant must demonstrate that the statute or provision causing the exaction itself provides, either expressly or by "necessary implication," that "the remedy for its violation entails a return of money unlawfully exacted." *Cyprus Amax Coal Co. v. United States*, 205 F.3d 1369, 1373 (Fed. Cir. 2000) (concluding that the Tucker Act provided jurisdiction over an illegal exaction claim based

upon the Export Clause of the Constitution because the language of that clause "leads to the ineluctable conclusion that the clause provides a cause of action with a monetary remedy").[31]

Applicability of the Tucker and Little Tucker Acts to the FBAR Penalty

The CFC has pointed out, "[t]he prototypical illegal exaction claim is 'a tax refund suit alleging that taxes have been improperly collected or withheld by the government.'"[32] A person can maintain a cause of action for illegal exaction by alleging that he paid money to the Federal Government and seeks the return of all or a part of that sum because it was "improperly paid, extracted or taken from the claimant in contravention of the Constitution, a statute or regulation."[33]

The Flora Rule does not apply.

A person who has paid money toward an FBAR assessment and who claims that the assessment was illegal is seeking to recover an illegal exaction from the Government. She can, therefore, maintain an action to recover the payment in either district court (if the amount the plaintiff seeks to recover is $10,000 or less) or the CFC. Because the FBAR penalty is not a tax but, instead, a civil penalty under Title 31, the long established rule in *Flora*[34] (holding that to maintain an action for refund of income tax under title 26, a taxpayer had to pay the full amount of the tax plus any penalties and interest) should not apply. The inapplicability of the rule in *Flora* is illustrated by several recent decisions of the CFC.

In *Ibrahim*,[35] the plaintiff filed an income tax return for 2011 that reported an overpayment and claimed a refund, based in part on the earned income credit. After the IRS notified the plaintiff that he was not eligible for the credit as claimed, he filed an amended return that claimed a refund. The IRS approved a refund of $1,962. Under 31 USC §3720A, a federal agency owed a past-due debt by any person may notify the Treasury, which can then offset any tax refund owed the person against the debt pursuant to Code Sec. 6402(d). Rather than issuing a check to the plaintiff, the IRS offset it against an education loan because the social security number of the loan recipient, Grant K. Anderson, matched the plaintiff's social security number.

Ibrahim claimed that he was not the loan recipient but, instead, was the victim of identity theft. Thereafter, the IRS then reversed its determination that the taxpayer was entitled to the refund it had issued and assessed $533 in additional tax plus interest. The plaintiff thereupon filed a suit in the CFC for the return of the funds that had been applied to the education loan. The Government moved to dismiss on the ground that under *Flora* a taxpayer may not maintain a refund suit unless he has paid in full the taxes, penalties and interest assessed for that year. The court granted in part and denied in part the Government's motion.

Because the plaintiff was *pro se*, the court liberally construed his pleadings as containing a cause of action for illegal exaction, over which the court had jurisdiction under the Tucker Act, 28 USC §1491. Under Claims Court jurisprudence, a person invoking its "jurisdiction based on an illegal exaction must demonstrate that 1) the exaction was directly caused by a misapplication of a statute, and 2) the remedy implicit in the statute is the return of the funds." The court noted that, under Code Sec. 6402(g), a suit to recover a refund that had been offset against another debt is not considered to be an action for tax refund.

The plaintiff claimed that the Government misapplied the refund offset statute because it applied the refund to a debt that he did not owe, since he was not the loan recipient and the Department of Education misapplied 31 USC §3720A when it used his refund to pay the debt of another person. The court had previously held that §3720A "implicitly requires a monetary remedy because 'absent a monetary remedy, a litigant has no recourse to recover … income tax refunds unlawfully offset'" (citing *Wagstaff*).[36] Because the court viewed the complaint as containing a cause of action for illegal exaction due to the offset of the tax refund, it denied the motion to dismiss. To the extent that the complaint was a tax refund claim, the motion was granted.

In *Kipple, supra*, the plaintiff's tax refund was offset against a student loan the Government claimed he owed. The plaintiff brought a *pro se* action in the CFC to recover the amount offset, alleging that there was no legally enforceable debt owed to the Government. The court held that it had jurisdiction under the Tucker Act because the plaintiff alleged an illegal exaction.

A person can maintain an illegal exaction claim without waiting for the Government to offset a tax refund or other payment against an assessment. As the Court of Claims put it in *Clapp*,[37] an illegal exaction has occurred when "the Government has the citizen's money in its pocket."[38]

The Government has effectively recognized that a person has a right to sue to recover payments toward an FBAR penalty in *Norman*.[39] In moving to dismiss the complaint, the Government argued that 28 USC §1355 vest the district courts with exclusive jurisdiction over cases seeking to recover penalties. The Government relied on *Crocker*,[40] which held that district courts have exclusive jurisdiction over suits to recover money or property held forfeit under federal law. The CFC rejected this argument, noting that in *San Huan New Materials High Tech, Inc. v. Int'l Trade Comm'n*,[41] the Federal Circuit held that §1355 "does not create a presumption that district courts must uniquely determine and assess, as well as enforce, all civil penalties." The CFC denied the Government's motion to dismiss. Noting that there was "substantial grounds" for a difference of opinion on the issue, the CFC suggested that the Government could seek an interlocutory appeal. The Government did not take up this suggestion.

The language of §1355 belies the claim that district courts alone have jurisdiction over suits against the United States to recover penalty payments. Subsection (a) of §1355 provides:

Regardless of the available judicial remedies in most cases, it will be in the best interests of the client to attempt to convince the IRS during either exam or appeal that the penalty does not apply or that the case is appropriate for settlement with IRS Appeals.

> The district courts shall have original jurisdiction, exclusive of the Courts of the States, of any action or proceeding for the recovery or enforcement of any fine, penalty, or forfeiture, pecuniary or otherwise, incurred under any Act of Congress, except matters within the jurisdiction of the Court of International Trade under section 1582.

The statute states that the jurisdiction of the district courts is "original" and "exclusive of the courts of the States." This means that the district court can hear the cases but state courts cannot hear them. Another limitation is that district courts do not have jurisdiction if the Court of International Trade has jurisdiction. Nothing in §1355 deprives the CFC of jurisdiction. Subsections (b) and (c) deal with forfeitures. When Congress wants to make jurisdiction exclusive to a court, it says so. Thus, 28 USC §1251 gives the Supreme Court "original" and "exclusive" jurisdiction over actions between two states and original but not exclusive jurisdiction over certain other types of action. District Courts have "original jurisdiction" over cases arising under the U.S. Constitution and U.S. laws and treaties under 28 USC §1331. They have original jurisdiction in diversity cases, so long as the amount in issue is over $75,000, under 28 USC §1332. State Courts also have jurisdiction over federal question cases and diversity cases unless jurisdiction is vested exclusively in a Federal Court.

Since §1355 does not grant exclusive jurisdiction to district courts over an action to recover a fine or penalty that has been illegally extracted, the CFC would have jurisdiction over an action to recover an FBAR penalty payment. Besides not excluding CFC jurisdiction, §1355 does not waive the United States' sovereign immunity. For a suit to be brought against the United States, there must be an express waiver of sovereign immunity.[42] A statute that confers subject matter jurisdiction over a court does not, without more, give the court jurisdiction over the United States. The waivers of sovereign immunity are contained in the Tucker Act and the Little Tucker Act.

The Government appears to accept that the CFC has jurisdiction over actions to recover payments toward FBAR penalties. It failed to seek an interlocutory appeal in *Norman*. In *Jurnagin*[43] it did not move to dismiss. Instead, it answered the complaint and instituted discovery. In its motion to dismiss in *Kentera*,[44] the Government asserted that Administrative Procedures Act review was not available for an FBAR penalty assessment because the person could pay all or part of the penalty and sue for a refund in district court or the CFC. The *Kentera* case is discussed below.

Because the *Flora* rule does not apply to non-tax cases, a person against whom an FBAR penalty is assessed should be able to pay a small portion of the assessment. There are no statutory or regulatory prerequisites for maintaining an action to recover an FBAR payment. As a result, there appears to be no need to file a refund claim. The period of limitations for bringing an action under the Tucker Act and the Little Tucker Act is six years after the cause of action accrues which is likely when a payment is made toward the FBAR.[45] There is no right to a jury trial in the CFC. There is also no right to a jury trial for an action to recover money from the Federal Government.[46] On the other hand, a person is entitled to a jury trial in an action brought by the Government to impose liability for a civil penalty.[47] Thus, if an action is brought in district court to recover $10,000 or less paid toward an FBAR penalty and the Government counterclaims for the unpaid balance, the plaintiff can demand trial by jury. If the Government does not counterclaim, there would be no right to a jury.[48]

Applicability of the Administrative Procedures Act

The Administrative Procedures Act ("APA") has played a very limited role in the history of litigating tax disputes. While the law concerning the validity of Treasury regulations has always played an important role in the tax law, the APA has not played a role in litigating tax disputes. But the FBAR penalty is not a tax and the litigation of it is not a tax dispute—and that is why the APA is potentially applicable to reviewing the actions of the Government in assessing the FBAR penalty. Two recent district court decisions discuss the applicability of the APA to FBAR penalty assessments, *Moore* and *Kentera*.[49] In both cases, the plaintiff sued for a determination that non-willful penalties were assessed in violation of due process and the APA. Due in part to the litigating position taken by the Government, the courts reached different results.

In *Moore*, the IRS assessed four $10,000 non-willful penalties against the plaintiff, who had failed to file FBARs although required to do so. Prior to the assessment, the plaintiff protested the proposed action to Appeals. Appeals sustained the proposed assessment. The notice to the plaintiff contained no explanation of the penalties. The Government answered the complaint and counterclaimed to reduce the penalties to judgment. The Government moved for summary judgment. Neither in its answer nor in its moving papers did the Government argue that the APA is inapplicable to FBAR assessments. Instead, it argued that the determination of whether the plaintiff was liable for the non-willful penalties is subject to *de novo* review and the question of whether the amounts assessed were appropriate is reviewed under an abuse of discretion standard. Because the plaintiff did not dispute the proposed standards of review, the court applied them.

Applying the *de novo* standard of review to whether the plaintiff was liable for the penalty, the court reviewed the evidence concerning whether plaintiff had reasonable cause for not filing FBARs. The plaintiff had an offshore account in the name of a shell corporation. He checked the box "no" in response to the question on Schedule B of his tax returns whether he had offshore accounts. He failed to disclose his offshore accounts to his return preparer. Because he did not present any evidence that he fell within the "reasonable cause" exception, the court held that he was liable for the non-willful penalty as a matter of law.

The court then turned to whether the amount assessed was an abuse of discretion. There is no statute or regulation governing the procedures to be used to assess FBAR penalties. Consequently, the IRS has considerable leeway in fashioning procedures, subject to constitutional limits.[50] The *Moore* Court held that as an "informal adjudication," the determination as to the appropriate amount of penalties is subject only to the due process clause and APA sec. 555(e), which requires prompt notice of a denial of an application or protest together with a brief statement of the grounds for the decision. The notice provided plaintiff failed to contain the requisite "brief statement." Sec. 706(2)(A) of the APA requires a court in these circumstances to determine if the agency action was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law." The record before it did not contain any evidence from which the court could make that determination.

The court allowed the Government time to submit additional evidence. After the Government did so, the court held that the amount of the penalties assessed was not arbitrary, capricious or an abuse of discretion. It entered judgment for the Government on its counterclaim, subject to offset for the $10,000 paid by plaintiff. Because the Government required plaintiff to incur legal fees to find out why the assessment was made, and the Government had inexplicably assessed the penalty for one year without affording him a pre-assessment hearing as promised, the court determined that penalties, fees and interest on the assessment would not run until the date judgment was entered.

In *Kentera*, the Government moved to dismiss on the ground that the assessment of the FBAR penalty is exempt from judicial review because the plaintiffs had an adequate remedy at law, since they could pay all or part of the assessments and sue to recover the payment in either district court or the CFC. The court held that a suit challenging an FBAR assessment was excepted from APA review because plaintiffs had an adequate remedy at law—they could pay and sue for recovery under either the Tucker Act of the Little Tucker Act. Since the APA did not apply, there was no waiver of sovereign immunity. The court therefore dismissed the case.

There are many unanswered questions concerning the applicability and use of the APA. Aggrieved parties normally want *de novo* review of the FBAR penalty by the court and review under the APA—if available—is for actions which are "arbitrary and capricious"—a much more limited standard of review. Nevertheless, bringing a claim under the APA may be appropriate—although one should expect a jurisdictional challenge by the Government.

Some Practical Considerations

This brings us to some practical considerations. While a person can sue to recover payments made toward an FBAR assessment, a major question is when to do so. Because an

FBAR assessment is not a tax, the Government's enforcement mechanisms are limited to those under the Federal Debt Collection Act ("FDCA").[51, 52] The collection methods available to the Government under the FDCA are:

1. Administrative offset,
2. Tax refund offset,
3. Federal salary offset,
4. Non-federal employee wage garnishment,
5. Referral to a private collection contractor,
6. Referral to a federal agency operating a debt collection center,
7. Reporting delinquencies to a credit rating bureau, and
8. Litigation and foreclosure.[53]

Unless it obtains and records a judgment, the Government does not have a lien against property of the debtor. Its only recourse is through federal offset or non-Government employee wage garnishment (which is limited to 15% of the person's take home pay).[54] A taxpayer who is not an employee would not be subject to the wage garnishment provisions. The time period during which the Government can bring an action to collect the penalty is two years from the assessment date.[55] If it fails to do so, its collection remedies are limited to those outlined in §3711(g)(9)(A)-(G) (that is, all remedies other than litigation and foreclosure).

The first consideration should be the strength of your client's case. This will require obtaining and evaluating all of the evidence surrounding the failure to file FBARs, including a) the opening and maintenance of the offshore accounts, b) any failure to report income from the offshore accounts, c) the preparation of the client's income tax returns and d) the client's communications with tax professionals concerning the offshore accounts. The Government will have a more difficult time proving a willful as opposed to a non-willful violation.

If the client has a viable defense to imposition of the penalty, you next have to consider whether it is reasonable to bring an action within two years of the assessment date or wait to see if the Government files a suit to collect the penalty. Waiting may make a lot of sense because the Government will not bring a lawsuit for every FBAR assessment. An evaluation should be made as to whether the Government is likely to bring a lawsuit. If the suit is not brought within the two-year statute of limitations, the Government will be limited to collection methods under the FDCA—which are limited.

Unless your client has a strong defense to liability, it is probably advisable to delay bringing an action until after the two-year period of limitation because if an action is filed before the running of the two-year period of limitations, it is likely that the Government will counterclaim for the unpaid balance. Waiting however has its costs. There is a very substantial accrual of interest, collection costs and penalties under the FDCA, which can amount to more than 30% over the two-year period,[56] so care must be taken in deciding on the appropriate course of action.

Conclusion

We are still in the early stages of FBAR litigation. With the IRS's current emphasis on increasing compliance by taxpayers with offshore accounts, there will be an increased use of FBAR penalties against taxpayers who were non-compliant and did not enter into the offshore voluntary disclosure initiative. If a client is facing potential FBAR penalties, it is essential that the practitioner conduct a thorough investigation in order to develop as compelling a case as possible. Regardless of the available judicial remedies in most cases, it will be in the best interests of the client to attempt to convince the IRS during either exam or appeal that the penalty does not apply or that the case is appropriate for settlement with IRS Appeals.

ENDNOTES

* The authors are former attorneys with the Tax Division of the U.S. Department of Justice and both have previously written about the FBAR penalty.

1 Steve Toscher & Michel Stein, *FBAR Enforcement Is Coming*, J. TAX PRACTICE & PROCEDURE, January 2004, at 27.

2 Comment by Supervisory Revenue Agent at International Tax Compliance Roundtable panel at the 2013 Annual Meeting of the California Tax Bar & the California Tax Policy Conference.

3 In *Zwerner* (SD FL No. 13-cv-22082-CMA), the Government filed suit to collect 50% FBAR willfulness penalties that had been assessed for four years. The jury returned a judgment upholding three of four 50% penalties. The case was settled while a motion was pending to set aside the judgment as violating the Eighth Amendment prohibition on excessive fines.

4 One of the authors was informed by an Appeals Officer that he was sustaining a proposed assessment of a 50% willfulness penalty because Appeals was required to review the revenue agent's determination for abuse of discretion rather than to settle the case by weighing the merits, since FBAR penalties were not imposed under Title 26.

5 If a revenue agent proposes the assessment of an FBAR penalty, the taxpayer has a right to appeal to the IRS Office of Appeals, which has authority to settle the penalty if the appeal is pre-assessment. If the appeal is post-assessment, an FBAR assessment "in excess of $100,000 cannot be compromised by Appeals without approval of Department of Justice (DOJ). See 31 USC 3711(a)(2) and 31 CFR §902.1(a) and (b). Once assessed, the penalty becomes a claim of the U.S. Government." *See* IRM 8.11.6.1.6 (Feb. 2, 2015). For Appeals Procedures in FBAR cases, *see* IRM 8.11.6 (Feb. 2, 2015).

6 *J.B. Williams III*, 131 TC 54, Dec. 57,547 (2008).

7 *Williams*, 2012 U.S. App. LEXIS 15017 (4th Cir. 2012), *rev'g* DC-VA, 2010 U.S. Dist. LEXIS 90794 (2010); *McBride*, DC-UT, 2012 U.S. Dist. LEXIS 161206 (2012).

8 *Moore*, DC-WA, No. C13-2063RAJ (Apr. 1, 2015; July 24, 2015); *Kentera*, DC-WI, No. 2:16-cv-01020 (Jan. 30, 2017); *Norman*, No. 15-872T (FedCl 2016); *Jarnagin*, 15-cv-01534 (FedCl).

[9] There are many other issues that must be considered in litigating the FBAR penalty—among others—standard of proof, the burden of proof, the meaning of "willfulness" under the FBAR statute and Eighth amendment limitations of the assessment of the FBAR penalty. These issues are beyond the scope of this article.

[10] 31 CFR 1010.306(c) (FBAR required where amounts in foreign accounts exceed $10,000) and 31 CFR 1010.350 (setting forth requirements for FBARs).

[11] Section 5314 is the statutory basis for the cases holding that the required records exception applies to foreign bank accounts.

[12] Act Sec. 1357(c) of P.L. 99-570 (1986).

[13] *See* Department of Treasury, *Report to Congress in Accordance with Section 361(b) of the USA PATRIOT Act* (Apr. 26, 2002), at 9, available online at *www.fincen.gov/news_room/rp/reports_coressng.html*.

[14] IR 2003-48; *see www.irs.gov/uac/IRS-and-FinCEN-Announce-Latest-Efforts-to-Crack-Down-on-Tax-Avoidance-Through-Offshore-Accounts*.

[15] Act Sec. 821 of the American Jobs Creation Act of 2004 (P.L. 108-357).

[16] 31 USC §5321(a)(5)(A), (B).

[17] 31 USC §5321(a)(5)(C), (D).

[18] Case No. SA CR 07-227-CJC (C.D. CA); *see www.ocregister.com/articles/olenicoff-572767- ocregister-court.html*.

[19] The text of the UBS deferred prosecution agreement is available online at *www.justice.gov/sites/default/files/tax/legacy/2009/02/19/UBS_Signed_Deferred_Prosecution_Agreement.pdf*.

[20] 28 USC §1491.

[21] 28 USC §1346(a)(2).

[22] 28 USC §1491.

[23] 28 USC §1346(a)(2).

[24] *Mitchell*, SCt, 463 US 206, 216–217 (1983), quoting *Testan*, SCt, 424 US 392, 400 (1976).

[25] *Mitchell, supra* note 24, 463 US at 218.

[26] *Bormes*, SCt, 568 US 12 (2012).

[27] *Eastport S.S. Corp.*, CtCls, 372 F2d 1002, 1007 (1967).

[28] *Testan*, SCt, 424 US 392 (1976).

[29] 424 US at 401–402.

[30] *Norman*, 429 F3d 1081, 1095 (Fed. Cir. 2005).

[31] *See also New York Life Ins. Co.*, 118 F3d 1553 (Fed. Cir. 1997) (holding that the CFC had jurisdiction over an action for return of a deposit of tax where the IRS failed to make a timely assessment; the refund claim provisions did not apply because the taxpayer was seeking the recovery of a tax deposit and not the refund of a tax payment).

[32] *Kipple*, 102 FedCl 773, 777 (2012) (quoting *Norman*, 429 F3d 1081, 1095 (Fed. Cir. 2005)).

[33] *Briggs*, DC-CA, 564 FSupp2d 1087, 1092 (2008) (allegations that a tax refund had been improperly offset to collect a debt was sufficient to state a cause of action under the Little Tucker Act).

[34] *Flora*, SCt, 362 US 145 (1960).

[35] *Ibrahim*, 112 FedCl 333 (2013).

[36] *Wagstaff*, 105 FedCl 99 (2012).

[37] *Clapp*, 117 FSupp 576, 580 (1954).

[38] *See also Suwanee S.S. Co.*, 279 F2d 874, 876 (1960) (ship owner may recover payment illegally exacted as a condition of receiving permission to sell ship to a foreign purchaser).

[39] *Norman*, FedCl, No. 15-872T (Apr. 11, 2016).

[40] *Crocker*, 125 F3d 1475 (Fed. Cir. 1997).

[41] *San Huan New Materials High Tech, Inc. v. Int'l Trade Comm'n*, 161 F3d 1347 (Fed. Cir. 1998).

[42] *Mitchell, supra* note 24.

[43] *Jurnagin*, No. 15-1534 (FedCl).

[44] *Kentera*, No. 16-1020 (ED Wis.).

[45] 28 USC §§2401(a), 2501. Because the FBAR penalty is not a Title 26 penalty, the Anti-Injunction Act (Code Sec. 7421) and the prohibition against declaratory judgments in tax cases (28 USC §2201(a)) would not apply. *See National Federation of Independent Business v. Sebelius*, SCt, 567 US 519 (2012). The period of limitations for bringing an action under the Administrative Procedures Act is also the six-year period contained in 28 USC §2401(a). *Wong v. Doar*, CA-2, 571 F3d 247, 263 (2009); *Wind River Mining Corp.*, CA-9, 946 F2d 710, 713 (1991).

[46] 28 USC §2402 provides that there is no right to a jury trial in an action against the United States in district court except for a tax refund suit.

[47] *Tull*, SCt, 481 US 412 (1987) a defendant was entitled to a jury trial under the Seventh Amendment in an action by the United States to impose a civil penalty for violation of the Clean Water Act, since it was an action to collect a debt.

[48] There may be good reasons to want or not want a jury—an issue which is beyond the scope of this article.

[49] *Moore,* DC-WA, No. 13-2063 (Apr. 1, 2016) and *Kentera*, DC-WI, No. 16-1020 (Jan. 30, 2017).

[50] *Vermont Yankee Power Corp. v. Natural Resources Defense Council*, SCt, 435 US 519, 543–544 (1978).

[51] 31 USC §§3701 *et seq.*

[52] *See www.calbar.ca.gov/Attorneys/Sections/Taxation/Publications/California-Journal-of-Tax-Litigation/2014-First-Quarter - fn47*.

[53] 31 USC §3711(g)(9)(A)-(H).

[54] 5 USC §5514(a) (Federal salary offset); 31 USC §3720D(b) (non-government employee wage garnishment).

[55] 31 USC §5321(b)(2).

[56] *See* 31 USC §3717.