FRAUD & NEGLIGENCE

Government Wins Second Willful FBAR Penalty Case: What *McBride* Really Means for Taxpayers

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Taxpayers with unreported foreign accounts may have a great deal more to be concerned about after the government's latest victory. Two courts now have given the IRS a much bigger stick by finding that a taxpayer's failure to file a required FBAR was "willful."

Taxpayers with undisclosed foreign accounts wish it were not the case, but the reality is that the U.S. government, after many years of inactivity and ineffectiveness, has taken several significant steps over the past few years to identify and punish failures to file Form TD F 90-22.1, "Report of Foreign Bank and Financial Accounts" (FBAR). These steps include:

- Enacting legislation obligating foreign institutions to automatically provide the IRS with information about U.S. accountholders.
- Paying handsome rewards to whistleblowers.
- Introducing a new information return forcing taxpayers to report certain foreign financial assets (including foreign accounts) to the IRS each year.
- Imposing multimillion dollar fines and disclosure duties on foreign banks that collaborated with taxpayers to evade U.S. taxes.
- Extracting valuable data about international tax transgressions from taxpayers participating in the Offshore Voluntary Disclosure Program.
- Criminally prosecuting FBAR offenders.

Another step has become apparent in the past few months, i.e., litigation to collect civil penalties for "willful" FBAR violations. To date, two cases have been decided, both in favor of the U.S. government—first in *Williams,* 131 TC 54 (2008) (*"Williams I"*), 106 AFTR 2d 2010-6150 (DC Va., 2010) (*"Williams II"*), *rev'd* 110 AFTR 2d 2012-5298, 489 Fed Appx 655 (CA-4, 2012) (*"Williams III"*), and most recently in *McBride,* 110 AFTR 2d 2012-6600 (DC Utah, 2012). What *McBride* really means for taxpayers with unreported accounts is explored below.

CRITICAL BACKGROUND INFORMATION

International tax disputes are complicated, and jumping in prematurely simply causes confusion. Thus, before analyzing *McBride* and the earlier *Williams* cases, we first need to cover the duties that come with having a reportable interest in a foreign account, as well as the potential penalties.

Congress enacted the Bank Secrecy Act in 1970. One purpose of this legislation was to require the filing of certain reports, like the FBAR, where doing so would be helpful to the U.S. government in carrying out criminal, tax, and regulatory investigations. [1] Among the important provisions of the Bank Secrecy Act is 31 U.S.C. section 5314. This statute, in conjunction with the underlying regulations and FBAR Instructions, requires the filing of an annual FBAR where:

(1) A U.S. person, including U.S. citizens, U.S. residents, and domestic entities,

(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, and

(5) The aggregate value of such account or accounts exceeded $10,000

(6) At any time during the calendar year at issue. [2]

Concerned with widespread noncompliance with the FBAR filing requirement, the U.S. government has taken action in recent years. For instance, Treasury transferred authority to enforce the FBAR provisions from the Financial Crimes Enforcement Network ("FinCEN") to the IRS in April 2003. 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. [3]

Congress, for its part, enacted new FBAR penalty provisions in October 2004 as part of the American Jobs Creation Act ("Jobs Act"). Under the law before the Jobs Act, which was applicable to the *McBride* case, the government could assert a civil penalty against taxpayers only where it could demonstrate that they "willfully" violated the FBAR rules. [4] If the government managed to satisfy this high evidentiary standard, it was authorized to assert civil FBAR penalties ranging from $25,000 to $100,000, depending on the highest balance of the unreported foreign financial account. [5]

After passage of the Jobs Act, the IRS may impose a civil penalty on any person who fails to file an FBAR when required, [6] unless the violation is due to reasonable cause. [7] For nonwillful or unintentional violations, the maximum penalty is $10,000 per violation. [8]

The Jobs Act calls for higher maximum penalties where willfulness exists. Specifically, where a taxpayer willfully failed to file an FBAR, the IRS may assert a penalty equal to $100,000 or 50% of the balance in the account at the time of the violation, whichever amount is larger. [9] Given the astronomical balances in some unreported accounts, FBAR penalties under the Jobs Act can be enormous.

Generally, U.S. citizens and residents have three main duties when they hold a reportable interest in a foreign financial account:

(1) Report all income generated by the account on the relevant federal income tax return (e.g., Form 1040).

(2) Check the "yes" box in Part III (Foreign Accounts and Trusts) of Schedule B to Form 1040 to disclose the existence and location of the foreign account.

(3) File an FBAR with Treasury by June 30 of the following year supplying additional information about the account.

Beginning in 2011, taxpayers have another duty—to report the foreign account on Form 8938 ("Statement of Specified Foreign Financial Assets"), depending on the facts. [10]

With respect to the second duty, above, Part III of Schedule B, Form 1040, contains an FBAR inquiry and a cross-reference. The IRS has slightly modified this language over the years, but the materials for 2000—relevant to *McBride*—stated the following: "At any time during 2000, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? *See instructions for exceptions and filing requirements for Form TD F 90.22.1*."

THE FIRST WILLFUL FBAR PENALTY CASE

The first case concerning the imposition of a civil "willful" FBAR penalty was the multi-year, multi-issue *Williams* trilogy. [11]

The Key Facts

Synthesizing various court documents and decisions, the facts underlying the *Williams* cases are as follows. [12] 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 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 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 republics of the former 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., a British Virgin Islands corporation controlled by the taxpayer. The accounts were designed to hold funds earned by the taxpayer from 1993 through 2000 in connection with his oil trading in Russia and his consulting for various companies.

The taxpayer used the same U.S. accountant for all the relevant years, 1993 to 2000, but did not discuss the foreign accounts with the accountant. Moreover, when the accountant sent him a questionnaire (a "tax organizer") in early 2001, to be completed by the taxpayer in order to assist the accountant in preparing Form 1040 for 2000, the taxpayer indicated that he never had a reportable interest in a foreign account.

In August 2000, Swiss government officials notified the taxpayer 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 on 11/13/00. The next day, the U.S. government directed Switzerland to freeze the accounts; 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 noncriminal basis, but no settlement was reached.

The IRS announced a tax amnesty program, the Offshore Voluntary Compliance Initiative (OVCI), in January 2003. [13] The OVCI offered lenient settlement terms to those taxpayers who came forward of their own free will. The taxpayer in *Williams,* 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 Service already had initiated a civil audit or criminal investigation of the taxpayer or a related entity, or after it had received information from a third party alerting the IRS to the taxpayer's noncompliance. [14]

The IRS first pursued criminal charges against the taxpayer. In May 2003, the taxpayer agreed to plead guilty to one count of criminal tax evasion and one count of criminal 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 in excess of $7 million in the accounts, and these funds generated more than $800,000 in passive income;

(4) He knew that the funds in the account constituted taxable income, but he chose not to report the income to the IRS in order to avoid the payment of taxes; and

(5) He was guilty of evading taxes during the relevant years and he was guilty 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. Never specifically mentioning the FBAR, the taxpayer stated:

"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."

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 Service initiated a civil examination against the taxpayer approximately one year after the criminal sentence was handed down. 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 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, the revenue agent asserted, under the FBAR law in effect for 2000, the maximum penalty of $100,000 per account for the two ALQI accounts on grounds that the taxpayer "willfully" violated the law. To be clear, the sanction imposed by the revenue agent was not $100,000 for failing to file an FBAR for 2000 reporting all accounts, but rather a fine of $100,000 for each undeclared account in 2000.

District Court Denies FBAR Penalties

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 court first indicated that the government did not adequately differentiate between simply failing and "willfully failing" to disclose an interest in foreign accounts. In this regard, the district court explained that, after examining all 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 in Part III of Schedule B of the taxpayer's Form 1040 for 2000 was checked "no" in response to the foreign-account question, and further recognized that the taxpayer did not initially file an FBAR for 2000. Nevertheless, the 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 district court, these "strongly indicate to the Court that [the taxpayer] lacked any motivation to willfully conceal the accounts from authorities after that point."

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 court identified the disclosures made by the taxpayer's attorneys in their meeting with the IRS in January 2002 and the revelations made in the course of applying for the OVCI in February 2003. These disclosures, noted the district court, indicated the taxpayer's "consciousness of guilt for evading income taxes, which he never equated with the foreign banking disclosure."

The court next stressed that a guilty plea to *certain* charges in a previous criminal trial did not necessarily support *all* civil penalties in a subsequent matter. The district court held the following on this score:

"The Government argues that Williams' guilty plea should estop him from arguing that he did not willfully violate [the FBAR filing law] 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 [the FBAR filing law]. 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 [the FBAR filing law] 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 [in Part III of Schedule B to Form 1040].’"

Court of Appeals Finds Willfulness

The Fourth Circuit in *Williams III* began its analysis by criticizing the legal standards on which the district court made its taxpayer-friendly decision in *Williams II.* In particular, the court of appeals indicated that the lower 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 erroneously concluded that the taxpayer in *Williams III* was not motivated as of the FBAR filing deadline for 2000 to continue concealing his foreign accounts.

Then, noting various judicial precedents in the *criminal* arena, the Fourth Circuit went on to explain what it considered the proper legal standard to be applied. In this regard, the court explained that willfulness can be inferred from a taxpayer's conduct designed to conceal financial information, and willfulness also can be inferred from a taxpayer's conscious effort to avoid learning about reporting

requirements, i.e., "willful blindness."

Where willfulness is a condition for *civil* liability, the court of appeals indicated that both knowing and reckless violations of a standard are sufficient to trigger liability. It then clarified that the actions or inactions of the taxpayer in *Williams* constituted, at a minimum, "reckless conduct, which satisfies the proof requirement [for civil willful FBAR penalties.]" [15]

The Fourth Circuit went on to state that the district court clearly erred in finding that the taxpayer did not willfully violate the FBAR rules for 2000. The court supported its decision on two grounds.

First, the appellate court pointed out that the taxpayer signed his 2000 Form 1040 under penalties of perjury, thereby swearing that he had examined the Form 1040, as well as all schedules and statements attached to the Form 1040, and that all items were true, accurate, and complete. The court then explained that taxpayers who execute a tax return and submit it to the IRS are deemed to have constructive knowledge of such return, and the taxpayer in *Williams III* was no exception to that principle.

According to the court of appeals, the instructions in Part III of Schedule B of 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 filing duty. The taxpayer testified that he did not review his 2000 Form 1040 in general or read the information in Schedule B in particular. The circuit court 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.

Second, the court of appeals held that the taxpayer's allocution at the criminal proceeding further confirmed that his failure to file a timely FBAR for 2000 was willful. Seizing on one tiny portion of the taxpayer's allocution, the court concluded that the taxpayer admitted his knowledge of the FBAR duty simply because he used the phrase "Department of the Treasury." This extremely tenuous line of reasoning went as follows:

"During that allocution, [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."

THE SECOND 'WILLFUL' CASE—*McBRIDE*

The *Williams* trilogy sparked much controversy and confusion. On one hand, some practitioners concluded that *Williams III* stood for the proposition that (1) the standard for asserting the higher civil FBAR penalties is willfulness, (2) in this context, the government can establish willfulness by showing that the taxpayer was merely reckless, (3) recklessness exists where a taxpayer does not read and understand every aspect of a tax return, including all schedules and statements attached to the return (including Schedule B), as well as any separate forms alluded to in the schedules (including the FBAR), and (4) the taxpayer's motive for not filing an FBAR is irrelevant. Other tax professionals saw *Williams III* as an aberration, based on narrow facts, with little precedential value.

The debate over the proper judicial interpretation of *Williams III* did not last long, though, as the second case addressing civil "willful" FBAR penalties, *McBride,* was decided less than four months later by a federal district court in Utah.

The Key Facts

Jon McBride, a U.S. citizen, was equal partners with Scott Newell in the Clip Company, LLC, which sold accessories that allowed people to carry mobile phones on their belts. [16] McBride was in charge of the financial operations of the Clip Company. As with many products nowadays, the phone accessories were not made in the U.S. but were produced by a Taiwanese manufacturer. [17]

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. 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 Clip Company, normally would 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. 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 "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, 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 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 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 McBride a written legal opinion about the Financial Master Plan. The opinion was prepared by the Estate Planning Institute, P.C., which—as McBride learned within a week of the July 1999 meeting—was an entity controlled by or otherwise related to MSA.

McBride entered into an "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 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 Newell, sent McBride a memo expressing certain concerns about the Financial Master Plan and enclosing a newspaper article explaining that holding foreign bank accounts often was associated with tax evasion and fraudulent activity. This did not dissuade McBride from proceeding.

The Financial Master Plan was convoluted, presumably by design, and the factual findings by the court left various aspects rather ambiguous. Accordingly, 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 McBride two foreign entities: Drehpunkt Ltd. (FE 1) and Lombard & Associates, Ltd. (FE 2). [18] 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 FE 1 and FE 2.

MSA also established two additional entities, in Canada, at the request of McBride: Phoenix Overseas Advisors, Ltd. (FE 3), and Global Securities Corporation (FE 4). Foreign brokerage accounts were then opened under each of these two Canadian entities to enable McBride to engage in securities transactions.

Also pursuant to the Financial Master Plan, 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 Bahamanian account of FE 1. It is unclear whether the Taiwanese manufacturer received a fee for this accommodation.

Let's take a simplified example to see how this arrangement might have functioned. Suppose the Taiwanese manufacturer sold each phone accessory to the Clip Company for $10, and the Clip Company, in turn, sold each accessory to the ultimate consumer for $30. This normally would yield a taxable profit for the Clip Company of $20 per accessory. If, however, the Taiwanese manufacturer 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 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 Bahamanian account of FE 1 to another foreign company controlled by MSA. This company then 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 McBride. The court indicated that 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 payment of regular business expenses for the Clip Company, distributions in the form of "partner draws" to McBride and Newell, mortgage payments for McBride's former wife, purchase of Christmas presents for McBride's parents, airline travel, automobile leases, investments in various entities, and satisfaction of outstanding legal fees.

In early 2001, 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 concern in McBride about the legitimacy of MSA. Therefore, in an attempt to recoup his funds, 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.

During 2000 and 2001, approximately $2.7 million of otherwise taxable Clip Company business profits were ultimately routed to McBride. The highest balances in the unreported foreign accounts are relevant, too. The district court, looking to the documentation presented by the Department of Justice, determined the following amounts:

Entity	Year	Highest Balance
FE 1	2000	$310,002
FE 2	2000	140,250
FE 3	2000	39,507
FE 4	2000	299,977
FE 1	2001	736,902
FE 2	2001	150,132
FE 3	2001	10,900
FE 4	2001	308,377

With respect to his Form 1040 for 2000, McBride worked with Craig Stayner ("Accountant Stayner"), who also served as the accountant for the Clip Company. McBride never discussed with Accountant Stayner his involvement with MSA, never provided him with any documentation related to MSA, and never mentioned that Accountant Taylor might have some information or expertise regarding the Financial Master Plan and international tax and reporting obligations.

Part III of Schedule B of 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 Treasury by the deadline of 6/30/01. Of course, 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.

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: 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 Treasury 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 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 FE 1 and FE 2, 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." That is, 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.

Holdings by the District Court

The district court ruled on both the burden of proof in civil FBAR collection cases and the elements of the "willful" FBAR penalty.

Burden of proof. The *McBride* court began its analysis by addressing the burden of proof issue. It explained that the relevant statute, 31 U.S.C. section 5321(b)(2), simply allows Treasury 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 on this issue, i.e., the district court in *Williams II.* There, it was determined that the burden of proof on the U.S. government 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 court in *McBride* reasoned as follows:

"The preponderance of the evidence standard applied by the district court in *Williams [II]* is the correct standard. 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 [relevant cases]." (Internal citations omitted.)

Willfulness issue. With the burden of proof issue resolved, the *McBride* 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 McBride had "willfully" failed to file FBARs for 2000 and 2001. Indeed, 18 pages of the district court's 25-page legal analysis are 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 in *Williams III,* the *McBride* court indicated that "willfulness" in this context includes not only knowing FBAR violations, but also reckless ones. 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. Finally, the 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.

The taxpayer had constructive knowledge of the FBAR filing requirement. The district court next turned to McBride's level of knowledge of the FBAR filing requirement. Its ultimate conclusion on this issue is remarkably clear, but the 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. The district court 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.

The *McBride* court next 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 a blank."

Fortifying its position, the *McBride* 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. The district 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 returns 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."

The taxpayer had actual knowledge of the FBAR filing requirement. More important, explained the district court, McBride had actual knowledge of the FBAR filing requirement. The court identified four items in support of this determination:

(1) McBride read the pamphlets and other promotional material provided by MSA, which explained the duty to report an interest in foreign financial accounts.

(2) 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.

(3) McBride engaged in an evasive course of conduct with the revenue agent during the audit, lying about certain facts and withholding information and documentation.

(4) McBride made statements at trial that contradicted his earlier sworn statements during the discovery phase of the trial.

The taxpayer acted with reckless disregard or willful blindness. The court identified a long list of items that, together, supposedly demonstrated that 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) McBride reviewed the memo and accompanying newspaper article sent by Accountant Taylor in August 1999, which expressed concern about the validity of the Financial Master Plan.

(2) McBride was already concerned about MSA in March 2001, well before he filed his Form 1040 for 2000.

(3) McBride knew that the purpose of the Financial Master Plan was to avoid taxation and certain reporting requirements.

(4) McBride knew the Financial Master Plan involved the use of foreign entities held by nominees.

(5) McBride's initial impression of the Financial Master Plan was that it constituted "tax evasion."

(6) McBride did not seek a legal opinion or guidance from outside, independent counsel.

(7) Part III of Schedule B, Form 1040, contained a "plain instruction" regarding disclosure of foreign accounts.

(8) McBride did not discuss with or provide information to either of his two accountants regarding his participation in the Financial Master Plan.

WHY *McBRIDE* IS IMPORTANT

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 some more obscure reasons why *McBride* is significant, too. These reasons, which have likely gone unnoticed by most taxpayers and practitioners, are examined below.

Government Seeks Small FBAR Penalties

As shown in the table, above, the court determined that McBride had a reportable interest in four foreign accounts in each of 2000 and 2001, whose balances ranged from $10,900 to $736,902.

The FBAR law applicable in 2000 and 2001 provided that willful violations triggered a penalty equal to "the greater of (I) an amount (not to exceed $100,000) equal to the balance in the account at the time of the violation, or (II) $25,000." Stated differently, if an unreported account had a balance of less than $25,000, then the penalty would be $25,000; if the account's balance was between $25,000 and $100,000, then the penalty would be the balance, and if the account's balance exceeded $100,000, the penalty would max out at $100,000.

Lest any doubt remain, the *Internal Revenue Manual* sets forth the Service's own view of this statute. It explains that "[t]he maximum penalty is limited to the amount in the foreign account at the time of the violation up to $100,000, except in cases where the maximum amount in the account at the time of the violation was less than $25,000 (in which case the maximum penalty amount is $25,000)." [19]

Curiously, the revenue agent in *McBride* asserted a civil FBAR penalty for each year (in the words of the opinion) "in the amount of $100,000 ($25,000 per account) for his willful failure to report his interest in the foreign accounts." In other words, the revenue agent asserted a penalty that may have been considerably lower than the statutory limits.

The Service's policy on FBAR penalties, contained in the IRM, makes this issue even more interesting. It expressly states that the FBAR penalty must be asserted on an account-by-account, year-by-year basis. For instance, it explains that "FBAR penalties are determined *per account, not per unfiled FBAR,* for each person required to file [and] penalties apply for each year of each violation." [20] Another section indicates that "[f]or violations occurring prior to October 23, 2004, a penalty up to the greater of $25,000 or the amount in the account (up to $100,000) may be asserted for willfully violating the FBAR requirements [and] the amount of the penalty is calculated *per account and per violation.*" [21] The IRS followed this policy in the earlier *Williams* case, asserting two maximum penalties of $100,000 per account.

Based on the law in effect at the time, the Service's guidelines about how to impose FBAR penalties, and the high balances of McBride's unreported foreign accounts, one would have expected the revenue agent to assert a total penalty of $664,507 (as shown in Exhibit 1) rather than $200,000.

Exhibit 1. Potential Maximum Penalties in *McBride*

Year	Highest Account Balance	Anticipated FBAR Penalty	
2000	$310,002	$100,000	
2000	140,250	100,000	
2000	39,507	39,507	
2000	299,977	100,000	
Total potential penalty for 2000:			$339,507
2001	$736,902	$100,000	
2001	150,132	100,000	
2001	10,900	25,000	
2001	308,377	100,000	
Total potential penalty for 2001:			325,000
Total potential penalty for both years:			$664,507

Failure to Prove Account Values on Pivotal Date

The district court stated that, in order for the U.S. government to prevail in an FBAR collection suit, it must prove seven elements, including that "the amounts of the penalties were proper." The government arguably failed to prove this element in *McBride,* although the taxpayer never raised this contention, and the district court did not unilaterally identify it.

To appreciate this issue, one must understand some key dates and temporal concepts. The applicable regulation explains that FBARs must be filed "with respect to foreign financial accounts exceeding $10,000 maintained during the previous calendar year." [22] Expanding on this language, the FBAR instructions say that each U.S. person with a reportable interest in a foreign financial account must file an FBAR if the aggregate value of the accounts exceeds $10,000 "at any time during the calendar year."

The breadth of this requirement is evident—an FBAR must be filed if the combined value of the foreign financial accounts surpasses the $10,000 threshold at any time from January 1 to December 31. The regulations further explain that the deadline for filing FBARs related to the preceding calendar year is June 30. [23] Thus, if a U.S. person had a financial interest in foreign financial accounts during calendar year 2011 and the value of those accounts topped $10,000 at any time during 2011, then the person had to file an FBAR by 6/30/12.

In isolation, the mechanics of filing an FBAR seem rather mundane. They become quite interesting, however, when contrasted with the penalty provisions. The law applicable in *McBride* stated that the FBAR penalty was calculated on the basis of the balance of the account "at the time of the violation." [24] Congress significantly modified the law in 2004, but the legislative changes did not affect timing; the current law still indicates that the penalty is based on the unreported account's balance "at the time of the violation." [25]

This raises an obvious question: When does an FBAR violation occur—June 30 (i.e., the deadline for filing the FBAR)? December 31 (i.e., the last day of the calendar year)? Neither the law nor the regulations specifically address this issue, but other IRS documents reveal the government's position. For example, an infamous IRS internal legal memorandum (ILM 200603026) states the following:

"The decision to base the FBAR penalty on the highest balance in an account during the year was a policy decision made during the development of the FBAR mitigation guidelines. Section 5321(a)(5), however, limits the amount of the penalty to [a particular amount] or the balance in the account *at the time of the violation which, for failure to report accounts, is June 30 of the succeeding year.*" (Emphasis added.)

This conclusion is also confirmed in the IRM, which states the following about when an FBAR violation occurs: "The date of a filing violation is June 30th of the year following the calendar year for which the accounts are being reported. This date is the last possible day for filing the FBAR so that the close of the day with no FBAR represents the first time that a violation has occurred. *The amount [balance] in the account at the close of June 30th is the amount to use in calculating the filing violation.*" [26]

In *McBride,* the court did not make any factual findings or rulings regarding the balances of the unreported accounts as of 6/30/01 (the date of the FBAR violation for 2000) or as of 6/30/02 (the date of the FBAR violation for 2001). Indeed, the district court held only that the four accounts "carried a balance of [a certain amount] in 2000" and "carried a balance of [a certain amount] in 2001."

One might argue, therefore, that the U.S. government, which indisputably has the burden of demonstrating that the amount of the FBAR penalties is proper, failed to meet its burden. This contention was absent from the court's opinion, implying that McBride's representatives did not raise it. Other taxpayers facing large FBAR penalties in the future sure might, though.

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 involves only money, not "important individual interests or rights." *McBride* 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 2005, the IRS issued ILM 200603026 on offshore issues, covering several items, including the burden on the IRS in civil FBAR penalties cases. The Service's position at that time, looking into its 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 Service must meet with respect to civil tax fraud cases where the Service 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 Service will need to meet the higher standard of clear and convincing evidence."

That was then and this is now. It is interesting to witness the Service's shift of position on the burden of proof issue during the *McBride* case. The government attorneys, anticipating that counsel for McBride might point to ILM 200603026, essentially explained to the district court on brief that the Service's position back in 2005 was, well, wrong, and it should be ignored altogether. The following shows more accurately how the IRS tried to distance itself from its earlier analysis:

"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...." [27]

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, as recently as January 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." [28]

Unexpected Interest Charges

Most people are fairly familiar with interest charges on tax underpayments and related penalties, but knowledge about interest charges connected to FBAR violations is less common. *McBride* presents an opportunity to highlight this obscure, yet important, issue.

This was a long affair: McBride signed up for the Financial Master Plan in 1999, implemented it in 2000 and 2001, the IRS began the audit in 2004, the revenue agent asserted FBAR penalties in the summer of 2007, the Department of Justice filed a complaint in district court in April 2009, and the district court finally issued its decision in November 2012. Many things were occurring during this period, including the accrual of interest on the FBAR penalties.

The relevant law, which is likely to be alien to many tax practitioners and their clients, generally provides that the head of an executive, judicial, or legislative agency is to charge interest on an outstanding debt to the U.S. government. [29] In terms of timing, the law states that interest starts to accrue on the date on which demand for payment is made. [30] The law further provides that, in addition to interest charges, the government is empowered to assess on a debt that is more than 90 days past due a penalty of up to 6% per year. [31]

In its Complaint filed with the district court, the U.S. government claimed that McBride was liable not only for the $200,000 in FBAR penalties, but also interest charges and another penalty for not paying the FBAR penalties within 90 days of the assessment back in the summer of 2007. The court upheld these claims, tacking on another $74,622 to McBride's already sizable bill to Uncle Sam.

Confusion About the Reasonable Reliance Defense

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

McBride began by arguing that he reasonably relied on Accountant Stayner with respect to his 2000 Form 1040. The district court quickly dispensed with this argument because McBride did not fully inform Accountant Stayner about his involvement with MSA and the Financial Master Plan. This ruling raises no concerns.

McBride then contended that he relied on MSA and its attorneys, presumably the ones that prepared the legal opinion about the Financial Master Plan. The court also swiftly rejected this position because such advisors lacked the necessary independence. This ruling does not cause any concerns either.

Finally, McBride maintained that he relied on Accountant Taylor with respect to his 2001 Form 1040. As explained above, the district court found that in August 1999 Accountant Taylor sent McBride a memo expressing concerns about the Financial Master Plan and enclosing an article addressing legal and compliance issues related to foreign bank accounts. The court came to the following conclusion about McBride's 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 the tax due.... This duty cannot generally 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 by failing to dispense proper advice does not render McBride's failure to report his interest in the foreign accounts any less willful."

This holding raises questions for three 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 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. [32] 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." [33]

The Supreme Court, for its part, has concluded that the IRS must liberally construe the reliance defense. In *Boyle,* 55 AFTR 2d 85-1535, 469 US 241, 83 L Ed 2d 622, 1985-1 CB 372 (1985), the Court stated that "[w]hen an accountant or attorney advises a taxpayer on a matter of tax law ... it is reasonable for the taxpayer to rely on that advice." The Supreme Court further acknowledged that "[m]ost taxpayers are not competent to discern error in the substantive advice of an accountant or attorney."

Second, in stating that McBride could not rely on others to file a return and pay the proper tax, the district court seemed 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 nondelegable ministerial tasks, such as actually filing or mailing a return or payment (which cannot constitute "reasonable cause"). [34] The Tax Court has explained the distinction that seemed to escape the district court in *McBride:*

"In general, a taxpayer's duty to file a return when due is a personal, nondelegable 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...." [35]

Third, the compression of the circumstances in 2000 and 2001, two separate tax years entitled to separate analysis, leads to curious reasoning. The district court indicated that McBride either had actual knowledge or at least constructive knowledge of the need to file an FBAR at the time he executed his Form 1040 for 2000. The court then explained that Accountant Taylor's facilitation of McBride's "willful blindness" the following year, 2001, "by failing to dispense proper advice" about the FBAR filing requirement, did not make McBride's failure to file an FBAR for 2001 less willful.

How could McBride have been "willfully blind" in 2001 if, according to the district court, Accountant Taylor was "fully aware of the [MSA] scheme yet failed to properly advise McBride to report his interests in the foreign accounts?" It is difficult to reconcile the concept of willful blindness, which entails intentionally keeping oneself in the dark about a potential duty, with reliance on an informed tax professional to provide proper advice about filing obligations.

FBAR Cases Generally Require a Full Trial

FBAR penalty cases that go to trial are not for the impatient. Indeed, as mentioned above, the transactions giving rise to the issues in *McBride* were implemented in 1999, yet the litigation did not conclude until November 2012, and a judicial appeal still might ensue.

The only two civil "willful" FBAR penalty cases, *Williams* and *McBride,* serve as warnings that these types of situations do not lend themselves to early resolution on brief. In both cases, the parties filed motions for summary judgment on the question of "willfulness," which the district courts rejected because of the inherently factual nature of the question.

Edging Toward Strict Liability

McBride also is 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 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 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 precedent], 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 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."

This final ruling by the district court in *McBride* is noteworthy because it is contrary to the position taken by the IRS, historically and recently. For instance, in the portion of the IRM discussing the notion of "willful blindness," the Service 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 blindness." [36]

The IRM goes on to explain that, even where a taxpayer admits knowledge about the FBAR question on Schedule B of Form 1040, willfulness exists only 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. [37] As recently as January 2013, IRS representatives have made additional statements that simultaneously support the principles in the IRM and minimize the holding in *McBride.* High-ranking IRS attorneys cleared the air in the following manner:

"Although two courts emphasized it in recent decisions, neither *Williams* nor *United States v. McBride* ... seems to turn on whether the foreign bank account box was checked on the taxpayer's return.... In *Williams,* other facts supported the application of a willfulness penalty, [the IRS attorney said], adding that the IRS is not instructing agents to set up cases based on how the box [on Schedule B, Form 1040] is marked. It looks at all the facts and circumstances and 'is not pushing the envelope' in a way that could result in lost cases [for the IRS]." [38]

Impact on the OVDP

The recent taxpayer losses in *Williams III* and *McBride* will trigger additional uncertainty for taxpayers who are considering participation in the Service's offshore voluntary disclosure program (OVDP) or who already are participating in the OVDP and are entertaining the idea of opting out to seek reduced penalties based on a lack of willfulness or the presence of "reasonable cause." [39]

Generally speaking, taxpayers participating in the OVDP must (1) file Forms 1040X for the last eight years, (2) pay the back taxes, 20% accuracy penalties, and interest charges with respect to the Forms 1040X, (3) file FBARs and all other required information

returns for the last eight years, and (4) pay a catch-all/FBAR penalty equal to 27.5% of the highest aggregate value of the offshore assets during the eight-year period. The IRS released a series of frequently asked questions (FAQs) to clarify common issues related to the OVDP.

FAQ 51 addresses the limited options available to taxpayers who are less than pleased with the proposed penalties by the IRS, including the potentially enormous FBAR-related penalty. The main path for dissatisfied taxpayers is to opt out of the OVDP under FAQ 51. Among the risks associated with opting out are facing a full-blown audit for all relevant years and the assessment of FBAR penalties higher than those offered within the OVDP.

After the taxpayer victory in *Williams II,* people speculated that many taxpayers would be emboldened to opt out and roll the proverbial dice with the Service's Examination Division and Appeals Office. As one article put it, a possible outcome of *Williams II* was that "some taxpayers will be encouraged to opt out of the voluntary disclosure initiative and take their chances with the normal FBAR penalty regime." [40]

That sentiment has rapidly changed, of course. More recent articles have hypothesized that *Williams III* may discourage borderline taxpayers from leaving the set terms of the OVDP, regardless of how distasteful they may be to them. [41] The government victory in *McBride,* unfortunately, may well serve to fortify this thought process.

CONCLUSION

As noted in the beginning of this article, the U.S. government has taken many steps and devoted significant resources over the past few years to reducing international tax noncompliance, including the hiding of foreign accounts by taxpayers who do not file FBARs. If the announcements by the IRS are to be believed, these enforcement efforts will only increase in the near future. Taxpayers with unreported foreign accounts and their advisors, therefore, must stay abreast of all material developments, such as the "willful" FBAR penalty collection cases, like *McBride.* With two victories under its belt already, and with the large number of U.S. taxpayers who have yet to become fully compliant, the U.S. government is likely to continue asserting and then litigating "willful" FBAR penalties in the coming years.

[1] P.L. 91-508 (10/26/70), section 202.

[2] See also 31 C.F.R. section 103.24.

[3] 31 C.F.R. section 103.56(g).

[4] 31 U.S.C. section 5321(a)(5)(A) (as in effect before 10/23/04).

[5] 31 U.S.C. section 5321(a)(5)(B)(ii) (as in effect before 10/23/04). Prior law stated that "in the case of violation of [31 U.S.C. section 5314] involving a failure to report the existence of an account or any identifying information required to be provided with respect to such account, [the penalty shall be] the greater of (I) an amount (not to exceed $100,000) equal to the balance in the account at the time of the violation, or (II) $25,000."

[6] 31 U.S.C. section 5321(a)(5)(A) (as in effect after 10/22/04).

[7] 31 U.S.C. section 5321(a)(5)(B)(ii) (as in effect after 10/22/04). The law and the Internal Revenue Manual clarify that penalty mitigation is feasible only if "reasonable cause" exists and the taxpayer agrees to file delinquent FBARs with the revenue agent as

part of the audit. IRM section 4.26.16.4.4 (7/1/08).

[8] 31 U.S.C. section 5321(a)(5)(B)(i) (as in effect after 10/22/04). The Service's position is that a $10,000 penalty may be imposed per account per FBAR.

[9] 31 U.S.C. sections 5321(a)(5)(C)(i) and (D)(ii) (as in effect after 10/22/04).

[10] For a detailed analysis of the Form 8938 filing requirement, see "The New Duty to Report Foreign Financial Assets on Form 8938: Demystifying the Complex Rules and Severe Consequences of Noncompliance," 38 Int'l Tax J. No. 3 (2012), page 11. See also Packman, "Foreign Account Reporting Using Form 8938—Has the Service Created Compliance Traps?," 116 JTAX 197 (April 2012).

[11] See Sheppard, "Third Time's the Charm: Government Finally Collects 'Willful' FBAR Penalty in *Williams,*" 117 JTAX 319 (December 2012).

[12] 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 official decisions in Williams, TC Memo 2009-81, RIA TC Memo ¶2009-081 (Tax Court decision granting the Service'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, TC Memo 2011-89, RIA TC Memo ¶2011-089 (Tax Court decision upholding the federal income taxes and civil penalties for 1993 through 2000). All of these documents are on file with the author.

[13] Rev. Proc. 2003-11, 2003-1 CB 311, section 1. See generally Ostrander, "The Offshore Credit Card and Financial Arrangement Probe: Fraught With Danger for Taxpayers," 99 JTAX 113 (August 2003).

[14] *Id.,* section 4.

[15] In a footnote, the Court of Appeals included 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."

[16] The facts, analysis, and holdings were derived primarily from McBride, 110 AFTR 2d 2012-6600 (DC Utah, 2012). The author also obtained and reviewed the following materials filed by the parties, which provided additional data: (1) Complaint dated 4/29/09, (2) Answer dated 6/18/09, (3) Plaintiff's Motion for Summary Judgment dated 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 dated 2/24/11, (7) Notice of Supplemental Authority by Plaintiff dated 5/13/11, (8) Plaintiff's Trial Brief dated 5/14/12, (9) Defendant's Trial Brief dated 5/14/12, (10) Transcript of Bench Trial Volumes I and II dated 7/2/12, (11) Plaintiff's Proposed Findings of Fact dated 7/23/12, and (12) Defendant's Proposed Finding of Facts dated 8/22/12.

[17] Certain documents filed by the Department of Justice indicated that the Clip Company also may have used another foreign

manufacturer.

[18] The materials filed with or issued by the district court in McBride indicate that another Bahamas entity—Palisades & Associates, Ltd.—was formed or made available to 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.

[19] IRM Exhibit 4.26.16-1 (7/1/08).

[20] IRM 4.26.16.4 (7/1/08) (emphasis added).

[21] IRM 4.26.16.4.5.5 (7/1/08) (emphasis added).

[22] 31 C.F.R. section 103.27(c).

[23] *Id.*

[24] 31 U.S.C. section 5321(a)(5)(B)(ii) (as in effect before 10/23/04).

[25] 31 U.S.C. section 5321(a)(5)(D)(ii).

[26] IRM 4.26.16.4.5.5 (7/1/08) (emphasis added).

[27] Plaintiff's Trial Brief, 5/14/12, pages 8-9.

[28] Coder, "Taxpayers Face Hurdles and Risks When Opting Out of OVDP," 2013 TNT 12-4 (1/17/13).

[29] 31 U.S.C. section 3717(a)(1).

[30] 31 U.S.C. section 3717(a)(2).

[31] 31 U.S.C. section 3717(e)(2).

[32] Reg. 1.6664-4(c)(1).

[33]

Reg. 1.6664-4(c)(2).

[34] Compare Boyle, 55 AFTR 2d 85-1535, 469 US 241, 83 L Ed 2d 622, 1985-1 CB 372 (1985), with Logan Lumber Co., 18 AFTR 2d 5475, 365 F2d 846 (CA-5, 1966), *aff'g* TC Memo 1964-126, PH TCM ¶64126 (reliance on an accountant to file is ordinarily no excuse for filing a return beyond the due date).

[35] Zabolotny, 97 TC 385 (1991) (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).

[36] IRM 4.26.16.4.5.3 (7/1/08).

[37] *Id.*

[38] Coder, *supra* note 28 (reporting remarks of John McDougal, IRS special trial attorney and division counsel, SB/SE).

[39] For another aspect of OVDP issues, see Ketcham, "Can IRS Be Trusted? A Troubling New Development in the Offshore Voluntary Disclosure Program," page 182, this issue.

[40] Coder, "Government Position on FBAR Penalties Called Into Question," 128 Tax Notes 1117 (9/13/10), 2010 TNT 173-2.

[41] Coder. "FBAR Penalty Case Reversal Raises Questions About Civil Willfulness Standard," 2012 TNT 142-2 (7/24/12).

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