Bait and Switch? Multi-Case Dispute Shows Risks of Participating in Certain IRS Disclosure Programs

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I. Introduction

A mindboggling number of people, taxpayers and advisors alike, erroneously believe that battling the Internal Revenue Service ("IRS") is a straightforward task. They think it is a simple matter of gathering supporting materials, presenting their factual, tax, and legal positions, arriving at a settlement, memorializing the terms in some type of agreement, and then forgetting about the whole thing forevermore. It is that easy, right? Wrong.

Successfully defending taxpayers against the IRS requires considerable strategy from beginning to end, as well as a profound understanding of the substantive rules and unique procedures. It also demands a true appreciation of the *pros* and *cons* of the many ways in which taxpayers can conclude a dispute with the IRS. When clashes with the IRS involve international issues, things become even trickier, with new layers of procedural chaos added. This is particularly true for taxpayers attempting to rectify past international non-compliance through the Streamline Domestic Offshore Procedure ("SDOP").

This article reviews the duties of U.S. persons holding foreign accounts, summarizes court holdings over the past decade about what constitutes a "willful" violation, provides foundational information about tax refunds, settlement agreements, and disclosure programs, and evaluates complexities associated with resolving global matters through the SDOP, using a recent case, *Estate of Jones v. United States*, as an illustration.[1]

II. Review of FBAR Issues

Readers need some background on FinCEN Form 114 ("*FBARs*") in order to appreciate the issues addressed in this article.

A. Origins, Power Delegations, and Penalties

Congress enacted the Bank Secrecy Act in 1970.[2] It created new provisions in Title 31 (Money and Finance) of the U.S. Code. One purpose of the legislation was to require the filing of certain reports, like the FBAR, where doing so would be helpful to the U.S. government in carrying out criminal, tax, and regulatory investigations.[3]

For many decades, the main problem was that few U.S. taxpayers filed an FBAR, and they had little incentive do so. Compliance was not rewarded, and violations generally went unpunished. In terms of statistics, one congressional report indicated that from 1993 to 2002 the U.S. government only considered imposing FBAR penalties in 12 cases. Of those dozen, only two taxpayers ultimately received penalties, four received "warning letters," and the remaining six were not pursued for various reasons.[4]

The U.S. government took action to rectify the situation. For instance, in 2003, the Treasury Department transferred authority to enforce the FBAR provisions from its Financial Crimes Enforcement Network to the IRS.[5] Thanks to a Memorandum of Agreement between the two agencies, the IRS was empowered to investigate potential violations, issue summonses, assess and collect civil penalties, issue administrative rulings, and take "any other action reasonably necessary" to enforce the FBAR rules.[6]

Current law dictates that the IRS can impose a civil penalty on any person who fails to file an FBAR when required, period.[7] In the case of *non-willful* violations, the maximum penalty is $10,000.[8] The IRS imposes higher penalties where willfulness exists. Specifically, in situations where a taxpayer *willfully* files a late, false, or incomplete FBAR, the IRS may assert a penalty equal to $100,000 or 50 percent of the balance in the undisclosed account at the time of the violation, whichever amount is larger.[9] Given the huge balances in some clandestine accounts, FBAR penalties can be enormous.

If the taxpayers do not voluntarily pay the penalties after the IRS assesses them, the Department of Justice ("DOJ") can start a collection action in federal court within two years.[10]

B. Multiple Mandatory Disclosures

The relevant law requires the filing of an FBAR in situations where (i) a U.S. person, (ii) had a direct financial interest in, had an indirect financial interest in, had signature authority over, or had some other type of authority over (iii) one or more financial accounts (iv) located in a foreign country (v) whose aggregate value was more than $10,000 (vi) at any point during the relevant year.[11]

When it comes to individuals, they have *several* obligations linked to holding an interest in a foreign financial account, aside from filing FBARs. These include, but are not limited to, the following:

- checking the "yes" box in Part III (Foreign Accounts and Trusts) of Schedule B (*Interest and Ordinary Dividends*) to Form 1040 (*U.S. Individual Income Tax Return*) to disclose the existence of the foreign account,
- identifying the specific foreign country in which the account is located, also in Part III of Schedule B to Form 1040, and
- declaring all passive income generated by the account on Form 1040, such as interest, dividends, and capital gains.[12]

Taxpayers must sign and date their Form 1040 in order for them to be valid. Many taxpayers are unaware that they are making the following broad, sworn statement to the IRS, which often comes back to haunt them:

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

C. Lessons from Past FBAR Cases

Several courts have examined what constitutes "willfulness" in the context of FBAR penalties. Among the many lessons taught by these cases are the following:[13]

- The Tax Court lacks jurisdiction over FBAR penalty matters, in both pre-assessment and post-assessment (*i.e.*, collection) cases, so FBAR litigation cannot take place there.
- The government is only required to prove willfulness by a preponderance of the evidence, not by clear and convincing evidence.
- The government can establish willfulness by showing that a taxpayer *either* knowingly *or* recklessly violated the FBAR duty.
- The concept of willfulness in the FBAR arena is expansive and encompasses reckless conduct,

considered from an objective point of view, even if such a conduct is not willful from a subjective perspective.

- In gauging whether a conduct is reckless, courts might turn to employment tax cases focused on trust fund recovery penalties for guidance.
- Recklessness might exist where a taxpayer fails to inform his accountant about foreign accounts.
- Recklessness might also exist where a taxpayer is "willfully blind" of his FBAR duties, which can occur when the taxpayer executes but does not read and understand every aspect of Form 1040, including all Schedules attached to Form 1040 (like Schedule B containing the foreign-account question) and separate forms referenced in the Schedules (like the FBAR).
- It is reckless for a taxpayer not to research the educational and professional credentials of the tax professionals on whom he is relying to prepare his U.S. returns.
- A person recklessly violates the FBAR duty when he clearly ought to have known that there was a grave risk of non-compliance and he was in a position to find out for certain very easily.
- Indicators of recklessness include a taxpayer starting to cooperate with the IRS only after his accounts have been revealed, filing FBARs reporting only small accounts while omitting large ones, asking a foreign bank not to send correspondence regarding accounts, and/or closing foreign accounts and repatriating funds without consulting U.S. advisors.
- Not reading the entire Form 1040 before signing it might constitute "extreme recklessness" by taxpayers, primarily because the foreign-account question on Schedule B is "simple and straightforward and requires no financial or legal training."
- If the taxpayer makes a damaging admission during a criminal trial, the government will use such a statement against him in a later civil FBAR penalty action.
- The taxpayer's motives for not filing an FBAR are irrelevant, because nefarious, specific intent is not necessary to trigger willfulness.
- The government can prove willfulness through circumstantial evidence and inference, including actions by the taxpayer to conceal sources of income or other financial data.
- In determining whether an FBAR violation was willful, courts might consider after-the-fact unprivileged communications between a taxpayer and his advisors.
- The courts review the question of willfulness on a *de novo* basis, meaning that a taxpayer generally cannot offer evidence at trial related to the IRS's administrative process in conducting the audit, determining whether willfulness existed, *etc.*
- Courts might reject as irrelevant reports and testimony from experts who attempt to link general public unawareness of FBAR duties to ignorance of the specific taxpayer under attack.
- In assessing FBAR penalties, the IRS can disregard its published guidance in the Internal Revenue Manual, such as the instructions about equitably allocating penalties related to foreign accounts with two or more co-owners.

III. Synopsis of Tax Refund Actions

Another item that readers must grasp to appreciate this article is the refund. Taxpayers sometimes overpay taxes, penalties, and other amounts, and they want their money back. Seeking a refund from the IRS is a surprisingly complicated process. Only the aspects pertinent to this article are set forth below.

The first step to recouping cash from the IRS is for a taxpayer to file a timely Claim for Refund.[14] A taxpayer normally must file a Claim for Refund within three years of the time that he filed the relevant tax return (regardless of whether such return was filed timely or late), or within two years of the time that he paid the relevant taxes, whichever period expires later.[15]

Claims for Refund must meet a list of requirements. For instance, they must explain in sufficient detail the factual, legal, tax, and procedural grounds on which the taxpayer deserves a refund, contain a signed declaration under penalties of perjury, utilize the correct IRS form, address only one type of tax for one tax period, and be filed with the proper IRS Service Center.[16]

If the IRS formally denies a Claim for Refund by issuing a Notice of Disallowance, then the taxpayer can seek judicial help by initiating a Suit for Refund in the proper District Court or Court of Federal Claims ("Claims Court").[17] The taxpayer can also file a Suit for Refund if the IRS simply ignores the taxpayer, failing to respond to his Claim for Refund for at least six months.[18] Importantly for this article, a prerequisite to filing a Suit for Refund with the courts is previously submitting a valid Claim for Refund with the IRS. Relevant law expressly states that a taxpayer cannot file a Suit for Refund "until a claim for refund or credit has been duly filed with the [IRS]."[19]

IV. Overview of Closing Agreements

Another initial concept that readers need to cover for purposes of this article is the so-called Closing Agreement.

The IRS can enter into a Closing Agreement with any taxpayer, concerning any tax and related items, for any period.[20] The rationales for the IRS to conclude a matter *via* a Closing Agreement are expansive. For instance, the IRS can utilize a Closing Agreement in any case where there appears to be a benefit in having it "permanently and conclusively closed," or if the taxpayer presents "good and sufficient reasons" for a Closing Agreement, and the IRS will not sustain any disadvantage.[21] The IRS, in its sole discretion, decides whether the criteria have been satisfied in a particular situation.[22] The IRS uses different types of Closing Agreements depending on the circumstances, including Form 906 (*Closing Agreement as to Final Determination Covering Specific Matters*).[23]

A recent Tax Court decision provided the following guidance about Closing Agreements and related contract principles: (i) Closing Agreements generally are final, conclusive, and binding on the parties; (ii) Closing Agreements may not be annulled, voided, modified, disregarded, or rescinded, unless there is a showing of fraud, malfeasance, or misrepresentation of material fact; (iii) Closing Agreements are strictly construed to encompass only the issues addressed therein; (iv) Recitals in Closing Agreements are explanatory and provide insight about the intent of the parties, but they are not substantive provisions; (v) Closing Agreements are contracts and subject to the normal rules of contract interpretation; (vi) Closing Agreements are interpreted according to the intent of the parties; (vii) Closing Agreements must be read as a whole, taking into account the context; and (viii) Courts cannot consider extrinsic evidence (*i.e.*, anything beyond the mere words of Closing Agreements) to determine intent, except in situations where the language of the Closing Agreements creates ambiguity.[24]

V. Voluntary Disclosure Programs

The final bit of background information that readers need in order to appreciate the issues in *Estate of Jones v. United States* centers on voluntary disclosure programs offered by the IRS. The IRS has introduced a long list of programs over the years to address different types of taxpayer non-compliance, both domestic and international. A comprehensive review of *all* disclosure programs would fill volumes. Therefore, this segment of the article limits itself to introducing the Streamline Foreign Offshore Procedure ("SFOP") and the SDOP.[25]

A. SFOP

In order to be eligible for the SFOP, a taxpayer (who is a U.S. citizen or Green Card holder) must meet the following criteria: (i) he was physically outside the United States for at least 330 days in one or more of the past three years; (ii) he did not have an "abode" in the United States during the relevant year; (iii) he either did not file annual Form 1040 with the IRS or filed annual Form 1040 that did not properly report all income from everywhere in the world; (iv) he might have also failed to file proper international information returns; (v) the violations were the result of "non-willful" conduct; (vi) neither the IRS nor the DOJ has initiated a civil examination or criminal investigation of the taxpayer or a related party; and (vii) the taxpayer is an individual (or the estate of an individual), because the SFOP is not open to entities.

Under the SFOP, a taxpayer is only required to file Form 1040 or Form 1040X (*Amended U.S. Individual Income Tax Return*) for the past three years, international information returns for the past three years, and FBARs for the past six years. The taxpayer must pay all tax liabilities and interest charges stemming from Form 1040 or Form 1040X, but the IRS does *not* impose any penalties whatsoever on taxpayers who successfully resolve matters through the SFOP.

B. SDOP

The SDOP is similar to the SFOP, with three critical distinctions. First, a participant in the SDOP does not satisfy the foreign-residency requirement; that is, the participant spent too much time in the United States. Second, the participant must have filed timely Form 1040 with the IRS each year, but neglected to report all worldwide income and/or enclose all required international information returns. Finally, if a taxpayer is accepted into the SDOP, the IRS does *not* waive all penalties. Instead of identifying and ticketing each specific unfiled FBAR or international information return, for each year covered by the SDOP, the IRS imposes, just once, a so-called miscellaneous offshore penalty ("MOP"). This fine is calculated by determining the highest total value of *all* non-compliant foreign assets during the entire disclosure period and multiplying that figure by five percent.

VI. Most Recent Case—*Estate of Jones v. United States*

The legal saga described from this point forward derives from four related federal cases, all of which involve Jeffrey and/or Margaret Jones. The Claims Court decided the most recent, and perhaps final, round of the dispute in August 2022. All facts, arguments, analyses, and quotes originate in a large number of filings with and by the courts in these cases.[26]

A. Relevant Background

This case involved an elderly couple. Jeffrey was born in New Zealand, lived there over 30 years, later relocated to Canada, and ultimately moved to California. For her part, Margaret was born in Canada and later settled in California with Jeffrey. They both became U.S. citizens in 1969. They each had high school education and worked for much of their lives as a dressmaker and secretary, respectively. Later, they started buying, repairing, and renting or selling properties.

Jeffrey held certain foreign accounts in his name, Margaret held some in hers, and they held others jointly. The foreign accounts, totaling 11, were located in countries with which they had logical connections, New Zealand and Canada. The taxpayers did not report their passive income from the foreign accounts on their joint Form 1040, they checked the "no" box in response to the foreign account question on Schedule B, and they did not file FBARs. Margaret maintained that she, and Jeffrey during his lifetime, believed that they would not be subject to U.S. income tax on the foreign funds until they repatriated them, which never occurred.

The accountant with whom Jeffrey and Margaret worked for nearly 30 years ("Accountant Burke") indicated to the IRS that he knew the taxpayers had previously lived in Canada, he never asked them about foreign accounts or foreign income, he was not familiar with FBAR reporting duties because he had no clients with international activities, and he did not review the annual Schedule B with the taxpayers.

B. Efforts to Rectify Past Non-Compliance

Jeffrey died in March 2013, when he was 93 years old. Margaret, as an executor of his estate, then sought legal advice about how to handle estate issues in New Zealand. Margaret claimed that she first learned about Jeffrey's personal accounts in New Zealand at that time, and started taking actions to correct matters. For instance, she filed a timely 2012 FBAR, filed delinquent FBARs for earlier years whose assessment periods remained open, and filed Form 1040X (*Amended U.S. Individual Income Tax Return*) for 2011 and 2012 reporting income from the foreign accounts.

Margaret later learned about the SDOP and applied for herself only.[27] As part of the SDOP application process, Margaret submitted several things to the IRS in March 2015. These consisted of (i) copies of Form 1040X for 2011 and 2012 that she previously filed, (ii) a copy of her accurate Form 1040 for 2013 that she timely filed, (ii) the MOP payment of about $157,000, which equaled five percent of the highest aggregate value of the unreported accounts during the relevant period, and (iv) a completed and executed Form 14564 (*Certification by U.S. Persons Residing in the United States for Streamlined Domestic Offshore Procedure*).

The final item, Form 14654, contained personal information about Margaret, explanations for unfiled FBARs and omitted income on prior Forms 1040, and reasons why, from her vantage point, the violations were non-willful and she should be eligible for the SDOP. Margaret executed Form 14654, thereby declaring that all the information she provided was "true, correct, and complete." Form 14654 featured some language that becomes critical several years later in the dispute. Below are the most relevant passages:

> In consideration of the [IRS's] agreement not to assert other penalties with respect to my failure to report foreign financial assets as required on FBARs or Forms 8938 or my failure to report income from foreign financial assets, I consent to the immediate assessment and collection of a [MOP] for the most recent of the three tax years for which I am providing amended income tax returns.
>
> I waive all defenses against and restrictions on the assessment and collection of the [MOP], including any defense based on the expiration of the period of limitations on assessment or collection.
>
> I waive the right to seek a refund or abatement of the [MOP].
>
> I recognize that if the [IRS] receives or discovers evidence of willfulness, fraud, or criminal conduct, it may open an examination or investigation that could lead to civil fraud penalties, FBAR penalties,

information return penalties, or even referral to Criminal Investigation.

C. Rejection of SDOP Application

The IRS did *not* simply accept Margaret's SDOP application, process the returns that she filed, deposit her MOP of about $157,000, and allow Margaret to go on her merry way. The IRS took the returns and the MOP payment, of course, but rejected the characterization of her behavior. Specifically, the IRS questioned Margaret's self-certification of non-willfulness on her Form 14564, started an audit, and ultimately assessed a "willful" FBAR penalty for 2011 of approximately $1.5 million.[28] In other words, the IRS imposed an FBAR penalty that was about 10 times greater than the MOP that Margaret previously paid.

The Examination Report listed several reasons for its determination that Margaret's FBAR violation was reckless, and thus willful. These included allegations that Margaret was fully aware of the existence of the foreign accounts, she communicated with her advisors regarding investment decisions and performance, she utilized foreign accounts to pay foreign expenses, she made cash withdrawals from foreign accounts while abroad, she possessed a certain level of sophistication thanks to her previous work as a legal secretary and a bookkeeper for multiple rental properties, she never asked Accountant Burke about U.S. treatment of foreign accounts, she never supplied Accountant Burke with foreign bank statements, she engaged in omissions that caused Accountant Burke to prepare false Form 1040 and to overlook FBAR duties, she executed Form 1040 that she knew were false, and she made several inaccurate or incomplete statements to the IRS on Form 14654.

The Examination Report conceded that the IRS had not uncovered any direct evidence that Margaret actually knew of her FBAR filing duty in 2011, but argued that she should be severely penalized nonetheless because "the foreign account balances and foreign income were clearly significant enough that the risk of harm for not making those disclosures [to Accountant Burke] was either known or so obvious that it should have been known."

D. Payment and Suit for Refund of FBAR Penalty

Margaret paid a portion the FBAR penalty, submitted a Claim for Refund for such penalty, and then started a Suit for Refund in District Court. She was 90 years old at the time. Importantly, Margaret *only* sought a refund of the FBAR penalty, *not* the MOP of approximately $157,000 that she previously paid when applying for the SDOP.

E. Motions for Summary Judgment

After a considerable amount of legal maneuvering, each party filed a Motion for Summary Judgment with the District Court.

1. Positions of the Parties

Margaret emphasized several points in her defense. The FBAR violation was unintentional, inadvertent, and a mistake based on a good faith misunderstanding of applicable law. All unreported foreign accounts were held in countries with which she and Jeffrey had a lifelong connection, Canada and New Zealand, not in some random tax haven. She only has a high school education, never attended college, and has no formal tax, accounting, legal, or financial training. She held all foreign accounts in her personal name, not through a foreign entity or agent. She had never heard of an FBAR in 2011. She believed that the foreign funds would only become an issue from a U.S. perspective when she repatriated them. She relied on Accountant Burke, who was aware of her Canadian background but never asked her about foreign accounts or income, never mentioned the FBAR, and never reviewed with her the foreign-account question on Schedule B to her annual Forms 1040. When she first learned about her FBAR duties in connection with her due diligence as an executor of Jeffrey's estate, she took pro-active steps to rectify matters with the IRS, including filing a timely 2012 FBAR, hiring legal counsel, applying for the SDOP, and paying the corresponding MOP. She reported the foreign accounts on Form 706 (*U.S. Estate Tax Return*) that she filed for Jeffrey's estate. She was over 90 years old and in poor health.

The DOJ presented the following counterarguments. Margaret responded "no" to the question about foreign accounts on Schedule B to her Form 1040. Schedule B specifically references the FBAR, such that Margaret had at least constructive notice of her duty. Margaret never told Accountant Burke about her foreign accounts or income and never provided him statements from foreign banks; therefore, she cannot raise a reasonable-reliance defense based on him. The DOJ only needs to show that Margaret acted "recklessly," and signing an inaccurate Form 1040 is *prima facie* evidence of recklessness. Even if Margaret lacked actual notice of her FBAR duties, her ignorance was attributable to her efforts to remain "willfully blind."

2. Preliminary Rulings by District Court

The Motions for Summary Judgment raised various issues, one of which was whether Margaret had willfully violated her FBAR duty for 2011. The District Court made the following observations and preliminary rulings on this issue. First, alluding to earlier FBAR cases, the District Court acknowledged that signing a Form 1040 is *prima facie* evidence that a taxpayer had constructive knowledge of the FBAR requirements. However, the District Court underscored that a taxpayer, like Margaret, can rebut this legal presumption, and the undisputed facts in her case cut both ways. It further stated that "signing a tax return on its own *cannot automatically* make the taxpayer's violation willful as that would collapse the willfulness standard to strict liability."[29] Second, the District Court rebuffed the DOJ's argument that Margaret's actions *after* the FBAR violation for 2011 (such as pro-actively filing a timely 2012 FBAR, applying for the SDOP, *etc.*) cannot affect a willfulness determination. It explained that Margaret's post-violation behavior provides circumstantial support for the notion that earlier transgressions were non-willful. Finally, the District Court ruled that granting summary judgment on the willfulness issue was impossible because a trial was necessary to clarify unresolved facts.[30]

F. Settlement of FBAR Case Before Trial

After the District Court ruled on the Motions for Summary Judgment in the two cases filed by Margaret and Jeffrey's estate, but *before* the start of the trial, two things occurred. First, the DOJ became the aggressor, filing a separate lawsuit in District Court seeking collection of the unpaid portion of the FBAR penalty. Second, and more importantly, Margaret and the DOJ agreed to settle all three cases.[31] Margaret apparently paid an FBAR penalty of about $1.3 million to end all matters, or at least she thought.

G. MOP Refund Suit

Margaret then died, and representatives of her estate took up the fight by filing a new Suit for Refund, this time in the Claims Court. That was the fourth lawsuit for those readers keeping track. Margaret was posthumously seeking *only* the return of the MOP of around $157,000 that she paid years earlier as part of her SDOP application. She was *not* asking for a refund of the FBAR penalty of about $1.3 million.

Some digging in the court filings reveals that Margaret's theory was that the government was forcing her pay twice for the same infraction. This is because, while the MOP constituted a broad, generic, fictional penalty to cover a taxpayer's failure to file FBARs (as required by Title 31 of the U.S. Code) *and* a long list of international information returns (as required by Title 26 of the U.S. Code), Margaret's *only* violation in her particular case was unfiled FBARs. In other words, she was not required to file any international information returns, and the IRS had no ability to impose other sanctions. Accordingly, Margaret's position seemed to be that by first paying the MOP of $157,000 and later paying the FBAR penalty of about $1.3 million, the government was essentially punishing Margaret two times for one violation. Margaret's perspective also might have been that the IRS can get the MOP, from taxpayers who resolve matters through the SDOP, or the IRS can get FBAR and international information return penalties, from taxpayers who are jettisoned from the SDOP, but not both.

Margaret raised two theories of IRS wrongdoing in her Suit for Refund, namely, breach of contract and illegal exaction. The analysis by the Claims Court was thorough, dense, and replete with legal citations supporting its statements. This article attempts to get to its essence.

1. Breach of Contract Theory

Margaret maintained that Form 14654 constituted an "offer" from the IRS, which she "accepted" by completing and filing Form 14654, and for which she paid adequate "consideration" in the form of the MOP. This "contract," continued Margaret, prohibited the IRS from asserting other penalties against her. Margaret seemingly relied on the following excerpt from Form 14654 to buttress her argument:

> In consideration of the [IRS's] agreement not to assert other penalties with respect to my failure to report foreign financial assets as required on FBARs or Forms 8938 or my failure to report income from foreign financial assets, I consent to the immediate assessment and collection of [the MOP] for the most recent of the three tax years for which I am providing amended income tax returns.

Further reflection reveals that Margaret was effectively asking the Claims Court to determine that she and the IRS had executed a "Closing Agreement" on Form 906, not a "Certification" on Form 14654, in connection with the SDOP. This makes sense from Margaret's perspective because, as explained above, Form 906 is subject to the rules of contract interpretation, they must be read as a whole and take into account the context, and they must be construed in accordance with the intent of the parties. It also makes sense because taxpayers often enter into Form 906 with the IRS to finalize items, such as participation in the longstanding Offshore Voluntary Disclosure Program.

The IRS countered that Form 14654 did not represent an offer, the IRS and Margaret did not have a contract, and the IRS did not commit itself to blanket restraint when it came to FBAR penalties. Indeed, the IRS emphasized that the express language of Form 14654 states that the IRS reserves the right to pursue additional FBAR penalties in certain circumstances:

> I recognize that if the [IRS] receives or discovers evidence of willfulness, fraud, or criminal conduct, it may open an examination or investigation that could lead to civil fraud penalties, FBAR penalties, information return penalties, or even referral to Criminal Investigation.

The Claims Court reviewed the four elements of contract formation, which consist of mutual intent of the parties to enter into a contract, payment of consideration, clear offer and acceptance, and actual authority by the IRS representative to bind the IRS in contract. The Claims Court found it sufficient to address just two elements.

It first explained that Form 14654 showed that mutual intent to contract did not exist, because it explicitly reserved the IRS's right to conduct an examination and assess additional penalties if the IRS were to determine that Margaret's behavior was willful, fraudulent, or criminal. The Claims Court augmented its point, indicating that the IRS protected its ability in Form 14654 to "assess further penalties without regard to the previous amount paid as the [MOP] and without indicating ... the amount or extent as to which penalties may be assessed."

The Claims Court next turned to the second element of contract formation, consideration. Again, looking to the specific language in Form 14654 about allowing the IRS to conduct an audit and impose additional penalties in appropriate circumstances, the Claims Court held that the IRS gave Margaret "the opportunity to try to resolve her tax obligations with limited penalties ... but the IRS did not renounce a later possible penalty for an examination into and a finding of willfulness, fraud, or criminal conduct." The Claims Court concluded that Margaret's prior payment of the MOP did not constitute sufficient consideration to establish a contract with the IRS.

Because Margaret failed to demonstrate the first two elements of contract formation, the Claims Court held that no contract existed between Margaret and the IRS, and dismissed her claim for breach of a contract that never was.

2. Dicta on Breach of Contract Theory

Given that this dispute involved four federal lawsuits and spanned many years, given that the critical issue of whether Margaret's FBAR violation was willful remained undecided, and given the overall importance of this question, the Claims Court expanded on its contractual analysis, even though it was unnecessary to do so.

As part of its defense to Margaret's contention that she was entitled to a refund of her MOP payment, the IRS argued that, even if Form 14654 constituted a contract between Margaret and the IRS, the IRS never breached it. The IRS again relied on the plain language of Form 14654, which permitted it to impose FBAR penalties, in addition to the MOP, if it examined a taxpayer applying for the SDOP, like Margaret, and concluded that her actions were willful, fraudulent, or criminal. The IRS examined Margaret and believed that her FBAR violation for 2011 was reckless, such that assessing a willful FBAR penalty was well within the contractual terms.

The Claims Court reviewed applicable cases, various court filings, and previous materials that Margaret submitted to the IRS, including Form 14654. It then observed that Margaret held several foreign accounts solely or jointly, she was aware of such accounts before applying for the SDOP, she did not disclose the accounts to Accountant Burke, and she executed and filed Form 1040 with the IRS falsely responding to the foreign-account question on Schedule B. These actions, opined the Claims Court, rise to the level of recklessness, which equates to willfulness in the context of FBAR violations. Consequently, even if Form 14654 were a contract between Margaret and the IRS, the latter did not violate it.

3. Illegal Exaction Theory

Margaret's second refund theory was that the IRS had no legal, statutory, or other authority to impose the MOP in the first place, so the IRS must return it.

The IRS countered that the substantive legal issue was irrelevant, because even if the IRS engaged in a so-called illegal exaction, Margaret failed to meet all the procedural requirements to fight about it. In particular, Margaret never filed a timely Claim for Refund of the MOP payment with the IRS, and never received a Notice of Disallowance from the IRS, before filing the Suit for Refund with the Claims Court. Consequently, the Claims Court had no authority to consider and rule on the issue.

The relevant provision, Code Sec. 7422, defines the items that taxpayers may seek and creates a procedural barrier to filing a Suit for Refund. It states the following:

> No suit or proceeding shall be maintained in any court *<u>for the recovery of any internal revenue tax</u>* alleged to have been erroneously or illegally assessed or collected, *<u>or of any penalty</u>* claimed to have been collected without authority, *<u>or of any sum</u>* alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the [IRS] ...[32]

The IRS explained that the MOP was created as a matter of "administrative expedience" for purposes of the SDOP, it is essentially a "substitute" for or a "consolidation" of many other international penalties that the IRS normally could impose against a taxpayer, and it should be treated as a tax for purposes of assessment and collection. Moreover, the IRS underscored that it had specific statutory powers to create and assert the MOP. It pointed to a provision broadly enabling the IRS to "administer, manage, conduct, direct, and supervise the execution and application of the internal revenue laws or related statues and tax conventions."[33] Finally, the IRS explained that at least one federal court has previously held that the MOP is a tax, albeit in a different context. The IRS emphasized, though, that characterization of the MOP was irrelevant because Margaret did not meet the prerequisites to file a Suit for Refund in the first place.

Margaret had another perspective, of course. She argued that the MOP is neither a tax nor a penalty because it is not specifically rooted in any provision of the Internal Revenue Code or its regulations. Consequently, she was not obligated to file a Claim for Refund with the IRS before lodging a Suit for Refund with the Claims Court.

The Claims Court sided with the IRS. It began by explaining that Code Sec. 7422 expressly covers "any internal revenue tax," or "any penalty," or "any sum" that was excessive or improperly collected by the IRS. It further stated that the modifier "internal revenue" seemingly only applies to taxes, not to penalties or sums. Thus, even if the MOP were not an "internal revenue tax" because it does not derive from the Internal Revenue Code, the Claims Court indicated that the MOP is a penalty or sum, both of which mandate the filing of a Claim for Refund. The Claims Court also pointed out that Margaret repeatedly used the term "penalty," both with the IRS and the Claims Court, when referring to the MOP. The Claims Court classified this as "an acknowledgement" that the MOP is a penalty, covered by Code Sec. 7422. Finally, the Claims Court cited precedent holding that Code Sec. 7422 contains "all-inclusive words," which should be interpreted accordingly. In summary, the Claims Court ruled that the MOP payment falls within "any penalty" and/or "any sum."

The Claims Court then turned to the manner in which Margaret provided the MOP payment to the IRS. It observed that the essence of a claim for illegal exaction is the IRS improperly withholding, collecting, or otherwise taking an amount from a taxpayer, like Margaret. The Claims Court explained that Margaret "volunteered" to participate in the SDOP, "accepted" its terms in hopes of minimizing her total liability to the IRS, and "consented" to the immediate assessment and collection of the MOP when she executed Form 14654. Accordingly, the Claims Court determined that an illegal exaction by the IRS had not occurred.

VII. Conclusion

Lessons from *Estate of Jones v. United States* largely center on the unique rules pertaining to the SDOP, but the case imparts some general wisdom, too. In particular, it underscores the need for all taxpayers to understand the factors that differentiate negligent from willful behavior, the relationship between a Claim for Refund and Suit for Refund, whether certain documents submitted to the IRS constitute a binding settlement, and the type of payments that taxpayers can and cannot recoup from the IRS. Congress recently granted the IRS billions of dollars to increase enforcement, the IRS already has in place several "compliance campaigns" addressing international issues, and the IRS' current "dirty dozen" list features foreign captive insurance companies, abuse of foreign pension plans, and hiding assets, including digital currency, in undisclosed foreign accounts. Together, this means heightened action in the international arena by the IRS, and the corresponding need for taxpayers to retain tax defense counsel with significant experience handling global disputes.

ENDNOTES

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[1] *Estate of Margaret J. Jones*, 130 AFTR 2d 2022-XXXX (Aug. 23, 2022).

[2] Pub. L. No. 91-508, Title I and Title II (Oct. 26, 1970). This law is also known as the Currency and Foreign Transactions Reporting Act.

[3] Pub. L. No. 91-508, Title I and Title II (Oct. 26, 1970) at §202.

[4] U.S. Treasury Department. A Report to Congress in Accordance with §361(b) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (Apr. 26, 2002), pgs. 9 and 10.

[5] 68 FR 26489 (May 16, 2003).

[6] Reg. §103.56(g), 68 FR 26489 (May 16, 2003).

[7] 31 USC §5321(a)(5)(A).

[8] 31 USC §5321(a)(5)(B)(i). The IRS cannot assert this penalty if the FBAR violation was not only "non-willful," but also due to "reasonable cause." *See* 31 USC §5321(a)(5)(B)(ii).

[9] 31 USC §5321(a)(5)(C)(i).

[10] 31 USC §5314, 31 USC §5321(a)(5)(A), and 31 USC §5321(b)(2).

[11] 31 USC §5314; Reg. §1010.350(a).

[12] In addition to these duties, taxpayers holding foreign financial accounts *after* 2011 generally must report them on Form 8938 (*Statement of Specified Foreign Financial Assets*). *See* Hale E. Sheppard, *Form 8938 and Foreign Financial Assets: A Comprehensive Analysis of the Reporting Rules after IRS Issues Final Regulations*, 41, 2 INT'L TAX J. 25 (2015); Hale E. Sheppard, *Specified Domestic Entities Must Now File Form 8938: Code Sec. 6038D, New Regulations in 2016, and Expanded Foreign Financial Asset Reporting*, 42, 3 INT'L TAX J. 5 (2016).

[13] *Williams*, 131 TC 54, Dec. 57,547 (2008); *Williams*, No. 1:09-CV-437, 2010 WL 347221 (E.D. Va. Sep. 1, 2010); *Williams*, CA-4, 2012-2 USTC ¶50,475, 489 FedAppx 655 (2012); *J. McBride*, DC-UT, Case No. 2:09-CV-378, Order (Nov. 8, 2012); *J. McBride*, DC-UT, 2012-2 USTC ¶50,666, 908 FSupp 2d 1186 (2012); *Bussell*, DC-CA, 117 AFTR 2d 2016-439 (Dec. 8, 2015); *A. Bohanec*, DC-CA, 2016-2 USTC ¶50,498, 118 AFTR 2d 2016-5537 (2016); *A. Bedrosian*, DC-PA, 2017-1 USTC ¶50,225, 120 AFTR 2d 2017-5671 (2017); *A. Bedrosian*, CA-3, 2019-1 USTC ¶50,113, 122 AFTR 2d 2018-7052, 912 F3d 144 (2018); *A. Bedrosian*, DC-PA, 505 FSupp 3d 502, 126 AFTR 2d 2020-7067 (2020); *N.E. Kelley-Hunter*, DC-DC, 281 FSupp 3d 121, 120 AFTR 2d 2017-5566 (2017); *Garrity*, DC-CT, Case No. 3:15-CV-243; *Markus*, DC-NJ, Civil No. 16-2133, Opinion, July 17, 2018; *Cohen*, 2018 WL 6318837 (C.D. California, Oct. 23, 2018); *Horowitz*, DC-MD, 123 AFTR 2d 2019-500 (Jan. 18, 2019); *E.S. Flume*, 390 FSupp 3d 847, 123 AFTR 2d 2019-XXXX (S.D. Texas, Jun. 11, 2019; *Boyd*, DC-CA, 123 AFTR 2d 2019-1651 (Apr. 23, 2019); *Rum*, DC-FL, 124 AFTR 2d 2019-5389 (2019); *Schwarzbaum*, DC-FL, 125 AFTR 2d 2020-1323 (2020); *Bernstein*, DC-NY, 126 AFTR 2d 2020-6053 (2020); *Ott*, DC-MI, 125 AFTR 2d 2020-1073 (2020); *Zimmerman*, DC-CA, 126 AFTR 2d 2020-6128 (2020); *A.B. DeMauro*, DC-NH, 483 FSupp3d 68, 126 AFTR 2020-6230 (2020).

[14] Code Sec. 6511(a).

[15] Code Sec. 6511(a); Reg. §301.6511(a)-1(a).

[16] Code Sec. 6402(a); Reg. §301.6402-2.

[17] Code Sec. 6532(a)(1); Reg. §301.6532-1(a); Code Sec. 7422(a).

[18] Code Sec. 6532(a)(1); Reg. §301.6532-1(a); Code Sec. 7422(a).

[19] Code Sec. 7422(a); Reg. §301.6402-2(a)(1).

[20] Code Sec. 7121(a); Reg. §301.7121-1(a); Reg. §601.202(a).

[21] Reg. §301.7121-1(a); Reg. §601.202(a)(2).

[22] Rev. Proc. 68-16, Section 3.01, 1968-1 CB 770.

[23] Reg. §601.202(b); Rev. Proc. 68-16, Sections 6.01 and 6.02, 1968-1 CB 770; IRM 8.13.1.2.1 (May 25, 2018).

[24] *J.K. Crandall*, 121 TCM 1272, Dec. 61,846(M), TC Memo. 2021-39; *See also* Code Sec. 7121(b).

[25] Hale E. Sheppard, *Alarming U.S. Tax Rules and Information-Reporting Duties for Foreign Retirement Plans and Accounts: Analyzing Problems and Solutions*, 129, 4 J. TAX'N 14 (2018) (explaining the four remaining international disclosure programs, as well as the now defunct Offshore Voluntary Disclosure Program).

[26] *Jones*, DC-CA, 125 AFTR 2020-2067 (2020). The author obtained and reviewed the following documents in preparing this article: Complaint for Illegal Exaction, filed Jun. 16, 2019; Answer and Counterclaim, filed Aug. 12, 2019; Answer to Counterclaim and Demand for Jury Trial, filed Sep. 3, 2019; Notice of Partial Concession by the United States, filed Mar. 31, 2020; Notice of Motion and Motion for Summary Judgment, or in the Alternative, Partial Summary Judgment by Plaintiff, filed Apr. 6, 2020; Memorandum of Points and Authorities in Support of Motion for Summary Judgment, or in the Alternative, Partial Summary Judgment by Plaintiff, filed Apr. 6, 2020; Notice of Motion and Motion for Summary Judgment by the United States, filed Apr. 6, 2020; Memorandum of Points and Authorities in Support of Motion for Summary Judgment by United States, filed Apr. 6, 2020; Plaintiff's Opposition to the Motion for Summary Judgment by United States, filed Apr. 13, 2020; Response by United States to Plaintiff's Motion for Summary Judgment, filed Apr. 13, 2020; Reply to the Opposition by the United States to Plaintiff's Motion for Summary Judgment, and in the Alternative, Partial Summary Judgment, filed Apr. 20, 2020; Reply by the United States in Support of its Motion for Summary Judgment, filed Apr. 20, 2020; Order Regarding Motions for Summary Judgment, issued May 11, 2020; Plaintiff's Memorandum of Contentions of Fact and Law, filed Jul. 20, 2020; Memorandum of Contentious Fact and Law by United States, filed Jul. 20, 2020; Stipulation for Dismissal, filed December 21, 2020. *See also Jones, as Executor, Estate of Jeffrey L. Jones*, Case 2:19-CV-00173 (DC-CA). The author obtained and reviewed the following documents in preparing this article: Complaint for Illegal Exaction, filed January 8, 2019; Answer and Counterclaim, filed Apr. 15, 2019; Answer to Counterclaim and Demand for Jury Trial, filed May 3, 2019; Order Regarding Motions for Summary Judgment, filed May 11, 2020; and Stipulation for Dismissal, filed Dec. 21, 2020. *See also Estate of Margaret J. Jones*, 130 AFTR 2d 2022-XXXX (Aug. 23, 2022).

[27] The court filings indicate that Margaret did *not* include the foreign accounts held individually by Jeffrey because of incomplete IRS guidance about post-death participation in the SDOP and her inability to make accurate sworn statements about the intent of Jeffrey, a deceased person.

[28] Court filings indicate that the IRS initially assessed FBAR penalties for both 2011 and 2012, and pro-rated the total penalty of about $1.5 million over the two years. The IRS later limited this to just 2011 because Margaret demonstrated that she filed a timely, accurate FBAR for 2012.

[29] *Jones*, DC-CA, 125 AFTR 2020-2067, Order (May 11, 2020) (emphasis added).

[30] Amanda Athanasiou, "FBAR Penalty Arbitrary and Capricious, U.S. Court Finds," Tax Analysts Doc. 2020-18568, 2020 Tax Notes Today Federal 94-10 (May 14, 2020).

[31] *Jones*, DC-CA, 125 AFTR 2020-2067 (2020). Stipulation for Dismissal, Dec. 21, 2020.

[32] Code Sec. 7422(a) (emphasis added).

[33] Code Sec. 7803(a)(2)(A).