Surprising FBAR Cases: A Mixed Bag for Taxpayers Facing Foreign Account Penalties

Hale E. Sheppard, Esq.

INTRODUCTION

Much of the tax press in recent years has focused on captive insurance, conservation easements, Employee Retention Credits, and other "hot" topics. However, international tax enforcement in general, and steep penalties for unfiled FinCEN Forms 114 ("FBARs") in particular, are still key issues. Global disputes rage and new law emerges, even though public attention is largely elsewhere for the moment. A great example is the changing landscape in foreign account fights. Several recent cases, largely unnoticed, have held that the IRS can extend the period for assessing FBAR penalties, despite the fact that the initial deadline expired. Another case ruled that FBAR penalties are "fines" for constitutional purposes, such that courts can reduce or remove them if they are "excessive." This article, which builds on two earlier ones by the author, examines disparate rules about extensions of assessment-periods in the tax and FBAR contexts, relevant IRS guidance, and recent cases centered on critical topics.[1]

VOLUNTARY EXTENSIONS IN THE TAX CONTEXT

The IRS normally has three years from the date on which a tax return is filed to identify it as problematic, conduct an audit, and issue its final report with proposed changes.[2] The official position of the IRS is that its auditors, known as Revenue Agents, generally should be capable of completing their work within the normal three-year period. Requests for extensions, therefore, should be rare.[3] That sounds good in theory, but the reality is that most Revenue Agents seek one or more "voluntary" extensions from taxpayers during audits. These extensions often are documented in Form 872 (Consent to Extend the Time to Assess Tax) or the appropriate version thereof.[4]

If the IRS determines that time is running short, it must secure a Form 872 from the taxpayer before the existing assessment-period lapses. This crucial concept derives from various sources. The key tax provisions and regulations, for instance, state that the IRS and taxpayer both must consent to an extension in writing "*before* the expiration of the time prescribed for the assessment of any tax" and, in the case of multiple extensions, "*before* the expiration of the period previously agreed upon."[5] Likewise, IRS training materials confirm that the assessment-period "*must still be open* when the [Form 872] is executed by both parties [because] it is *an agreement to extend* the statute of limitations on assessment, *not an agreement to revive* an expired statute of limitations."[6] Finally, several cases have held that Forms 872 and similar waivers supplied by taxpayers *after* the assessment-periods had expired were invalid.[7]

VOLUNTARY EXTENSIONS IN THE FBAR CONTEXT

U.S. persons normally must file an FBAR in situations where they had a reportable interest in one or more financial accounts located in a foreign country whose total balance was more than $10,000 at any point during the relevant year.[8] Importantly, FBAR duties and penalties are found in Title 31 of the U.S. Code (which addresses financial issues), whereas tax duties and penalties originate in Title 26 (the IRC). It is also crucial to appreciate that taxpayers voluntarily extend FBAR periods by executing a "Consent to Extend the Time to Assess Civil Penalties Provided by 31 U.S.C. 5321 for FBAR Violations" ("FBAR Consent"), as opposed to a Form 872.[9] These distinctions have major consequences.

INTERNAL IRS GUIDANCE

Few people seem to be aware, but the IRS issued internal guidance allowing or encouraging its personnel to seek FBAR Consents after the fact. Case in point, the IRS released a Voluntary Disclosure Practice Examiner Guide Paper for workers handling international non-compliance cases ("Guide Paper").[10] It indicates that the "FBAR statute may be extended or waived by the taxpayer *after expiration*" and "an expired FBAR statute *can be resurrected* with taxpayer consent."[11] The Guide Paper further explains that an FBAR Consent "is a common law waiver" of the assessment-period, while a Form 872 "is an anomaly for waivers in that it requires an open statute in order to extend."[12] Lastly, the Guide Paper states that "unlike Title 26 statutes, Title 31 FBAR statutes *can be resurrected after the statute expire*s through the execution of a consent."[13]

RECENT CASES APPLYING UNIQUE FBAR RULES

There is a growing series of cases adhering to the IRS's position, as described above. Several courts have held that the IRS is able to obtain an FBAR Consent from taxpayers, even though the earlier assessment-period has already expired. This article analyzes four such cases.

First Case

In *United States v. Solomon*, the IRS assessed FBAR penalties for 2004 through 2010.[14] The taxpayer took the position that the assessment-periods for essentially all years had expired before the IRS secured the FBAR Consents, such that the penalties were invalid. The taxpayer argued that "Congress did not even specifically authorize any extension of the [assessment] period for FBAR penalties under [Title 31], let alone provide clear congressional intent to allow revival through agreement of expired [assessment] periods."[15] The government, for its part, countered that the

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

© 2024 Thomson Reuters

six-year period set forth in the relevant provision in Title 31 is a "non-jurisdictional defense that can be waived [by taxpayers], even after it expires."[16]

The court agreed with government, ruling that it was not too late for the IRS to assert FBAR penalties for the relevant years. Turning to the relevant rule in Title 31, the court held as follows:

> It is clear from the face of the limitations period in [Title 31], which does not refer to the court's jurisdiction in any respect, that it operates merely as an affirmative defense [for the taxpayer], not as a limit or condition on the court's jurisdiction . . . Because [the relevant provision in Title 31] is not jurisdictional, the limitations for assessing FBAR penalties may be waived by the [taxpayer], even for claims that have expired.[17]

Second Case

The taxpayer in *United States v. Herscovici* apparently failed to file FBARs for 2008 through 2011 to disclose his foreign accounts.[18] The IRS sent the taxpayer the equivalent of an Examination Report on March 29, 2018, explaining why penalties applied. Over a year later, *after* the original assessment-periods had long expired, the taxpayer executed FBAR Consents for all years. Within a month of getting the extra time, the IRS assessed the highest possible FBAR penalties against the taxpayer, for "willful" violations. Then, less than a week later, the IRS sent the taxpayer a notice and demand for payment. He refused to pay, so the government filed a collection suit. It appears that the taxpayer did not defend himself or otherwise participate in the trial; therefore, a dispute over timeliness of the FBAR assessment did not arise. The court's perspective on that issue was clear nonetheless:

> The IRS was initially required to assess FBAR penalties for the 2008, 2009, 2010 and 2011 years by June 30, 2015, June 30, 2016, June 30, 2017, and June 30, 2018, respectively. The IRS initiated its assessment of penalties in January 2014, and the proposed penalties for years 2008 through 2011 were issued on March 29, 2018. On July 30, 2019, [the taxpayer] stipulated to extend the 2008, 2009, 2010 and 2011 penalty assessment deadline to June 30, 2020. Following the stipulation, on August 21, 2019, the IRS assessed willful FBAR penalties on [the taxpayer] for years 2008 through 2011, before the stipulated penalty assessment deadline. Accordingly, [this] weighs in favor of granting the [government's] motion for default judgment.[19]

Third Case

Judicial endorsement of reviving expired assessment-periods was more subtle in United States v. Sinyavskiy.[20] In that case, the taxpayer was a U.S. citizen, he held bank accounts in Switzerland, and he failed to submit timely FBARs for 2006 through 2012. On April 1, 2017, a point at which the normal six-year period for 2006, 2007, 2008, and 2009 had already expired, the taxpayer executed an FBAR Consent for all years. The IRS assessed non-willful penalties against the taxpayer during the extended periods, and then sent a notice and demand for payment. The taxpayer declined to pay, at which point the government filed a collection suit. The taxpayer kept his distance, not challenging the penalties or otherwise engaging in the litigation process. The government, therefore, filed a Motion for Default Judgment. The court approved, holding that the facts establish that it had jurisdiction to rule on FBAR penalties.[21]

Fourth Case

The most recent case was *United States v. Rund.*[22] The taxpayer in that dispute was a U.S. citizen, who moved to Hong Kong around 1980 and started an appliances company. He later formed or acquired at least two other foreign companies there. The taxpayer had an interest in various foreign accounts, which he held directly, indirectly via a foreign entity, or through a friend. The taxpayer was non-compliant with his U.S. duties in several ways, including not filing FBARs declaring the foreign accounts. In 2010, the taxpayer learned that one of the foreign banks at which he held accounts was under investigation by the U.S. government, so he applied for the Offshore Voluntary Disclosure Program ("OVDP"). The IRS reviewed his application, conducted an audit, determined that the taxpayer had "willfully" violated his FBAR duties over 40 times, and assessed a penalty of approximately $3 million.

The taxpayer, like many before him, declined to pay the large sanction. The result was the filing of a collection lawsuit by the government. After the discovery process ended, the government and the taxpayer filed Cross-Motions for Summary Judgment, essentially asking the court to dispense with several legal issues before trial. One of those issues was whether the government was banned from collecting the FBAR penalties because the IRS had assessed them too late.

The court acknowledged that, if the normal assessment-period of six years applied, the IRS would have been out of luck. However, underscored the court, the normal period did not govern the case. It explained that, starting in 2015, the taxpayer gave his "repeated consent" to extend the deadline. The taxpayer first executed an FBAR Consent prolonging the deadline until June 2017. The IRS allowed that period to lapse. Therefore, in 2019, the IRS persuaded the taxpayer to execute another FBAR Consent, this time expanding the deadline to December 2021. The IRS then assessed the FBAR penalties during the second extension, in April 2021.

The court, citing to the cases analyzed earlier in this article, indicated that "[w]hile it is true that [the taxpayer] gave consent to extend the assessment deadline in 2019 *after* the previous deadline had already passed, this consent can still stand." The taxpayer seemed to concede this point, yet asked the court to "reevaluate the underlying logic" of the judicial precedent. The court passed on the offer for a few reasons. One, the taxpayer failed to supply any legal support for his position. Two, an assessment-period generally is not jurisdictional in nature. Third, alluding to the what-is-good-for-the-goose-is-good-for-the-gander refrain, the court pointed out the following: The taxpayer "twice decided to consent to an extension, and accordingly, he benefitted from additional negotiation time and delay in collection . . . He may not now dispute these consents to halt the government's collection of its penalties."

RAY OF HOPE FROM COURT OF APPEALS

The Guide Paper from the IRS, combined with the four recent cases discussed in the preceding section of this article, create significant gloom for taxpayers facing FBAR penalties. Not all is lost, though. A very recent case, issued by the Court of Appeals for the Eleventh Circuit, held that FBAR penalties are "fines" and they can violate the "Excessive Fines Clause" of the U.S. constitution in certain circumstances. The case, which addressed a "fundamental

© 2024 Thomson Reuters

question" and represented "a matter of first impression" for the Eleventh Circuit, is *United States v. Schwarzbaum*.[23]

The taxpayer was born in Germany, and lived in many different countries. His considerable assets derived from his father, a successful businessman and investor, either by gift (during his life) or bequest (upon his death). The taxpayer had no tax-related skills, education, or training. He became a Green Card holder in 1993 and a U.S. citizen in 2000. The taxpayer began holding foreign accounts in 2001, and had a reportable interest in 20 accounts, located in Switzerland and Costa Rica, during the relevant years.

In late 2009, one of the taxpayer's foreign banks sent him a letter indicating that the government was seeking information about U.S. account holders, like him. The taxpayer, through a Swiss attorney, unsuccessfully attempted to prevent the bank from disclosing his data. He then applied for the OVDP, opted-out, and faced an IRS audit. The Revenue Agent first imposed FBAR penalties for 2006, 2007, 2008, and 2009 totaling about $35 million, which he later decreased to approximately $14 million under the applicable mitigation standards.

The taxpayer refused to pay such penalties, so the government started a collection lawsuit. The trial court held in favor of the government with respect to various years on grounds that the taxpayer showed "recklessness" and "willful blindness" regarding his FBAR duties. Appeals by the taxpayer ensued. In the most recent round, the Eleventh Circuit concluded as follows about the classification of FBAR penalties as "fines:"

> No matter how you cut it, it's apparent that this statute is designed to inflict punishment at least in part. Whether we look at the text and structure of the statute . . . or at the deterrent reasons Congress has articulated for creating the penalty scheme, by every reasonable measure, the FBAR penalty has a powerful punitive purpose. We hold, therefore, that the FBAR penalty is a fine subject to the Eighth Amendment's Excessive Fines Clause.[24]

The decision, above, by the Eleventh Circuit stands in direct contrast to an earlier one on the same issue by the First Circuit.[25] The Eleventh Circuit boldly stated that it was "unpersuaded" by the prior reasoning of its judicial colleagues.[26]

After holding that FBAR penalties constitute "fines" subject to constitutional limitations, the Eleventh Circuit analyzed whether such fines were "excessive" when it came to the taxpayer. It explained that it could not focus on the aggregate FBAR penalties in his case; rather, it needed to "proceed carefully on an *account-by-account basis* precisely because the statutory regime characterizes *each* failure to report a bank account as a violation in and of itself."[27] The Eleventh Circuit focused on just three of the unreported accounts, all of whose highest balances were around $15,000, and all of which were hit with a penalty of $100,000. The Eleventh Circuit opined that a "$100,000 penalty for an account holding comparatively small amounts of currency strikes us as being grossly disproportional to the gravity of the [taxpayer's] offense."[28] Therefore, it sent the case back to the trial court, instructing it to eliminate the three "excessive fines" totaling $300,000.[29]

CONCLUSION

This article shows a good-news-bad-news situation for taxpayers with FBAR penalty problems. On the negative side, at least four cases have determined that, while the IRS cannot impose *taxes* after the assessment-period has expired, it can resuscitate a dead period when it comes to *FBAR penalties*. On the positive side, all four of the decisions about revival of close periods were made at the lowest judicial level, with no review by a Court of Appeals yet. Another uplifting note is that the Eleventh Circuit, rejecting the earlier analysis by the First Circuit and every trial court that has considered the question, recently held in *United States v. Schwarzbaum* that FBAR penalties constitute "fines" for constitutional purposes, which are vulnerable to reduction or removal if they are "excessive." Taxpayers embroiled in international tax disputes should be watching these key FBAR issues, and related ones, to see how they evolve.

End Notes

[1] *See* Hale E. Sheppard, "IRS Claims It Can Revive Closed Assessment-Periods in International Tax Disputes," 139(2) *Journal of Taxation* 21 (2023); Hale E. Sheppard, "More on Strategies to Reopen Closed Assessment Periods," 140(2/3) *Journal of Taxation* 12 (2024).

[2] Section 6501(a).

[3] Rev. Proc. 57-6; IRM § 25.6.22.2.1 (3-26-2019).

[4] Section 6501(c)(4)(A). *See* IRM Exhibit 25.6.22-1.

[5] Section 6501(c)(4)(A); Treas. Reg. § 301.6501(c)-1(d).

[6] IRS Large Business & International Concept Unit. Overview of Statute of Limitations on Assessment of Tax (Nov. 6, 2019) (emphasis added); "IRS Updated Practice Unit on Limitations Period for Assessing Tax," 2020 Tax Notes Today International 71-22 (April 10, 2020).

[7] *See, e.g.*, *United States v. Spohrer*, 38 AFTR 2d 76-5832 (Dist. Ct. FL 1976); *Cary v. Commissioner*, 48 T.C. 754, 760 (1967); *Berry v. Commissioner*, 97 T.C. 339, 347 (1991).

[8] 31 U.S.C. § 5314; 31 CFR § 1010.350(a). In this context, U.S. persons have a "reportable interest" if they had a direct financial interest in, had an indirect financial interest in, had signature authority over, or had certain other types of authority the financial accounts.

[9] Internal Revenue Manual § 4.26.17.3.1.3 (12-11-2019); Internal Revenue Manual Exhibit 4.26.17-6.

[10] IRS Voluntary Disclosure Practice Examiner Guide Paper (Rev. 1/26/22); IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022); Andrew Valverde, "IRS Voluntary Disclosure Guide Reveals New Details of Practice," 2022 Tax Notes Today Federal 138-3 (July 20, 2022).

[11] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 39 (emphasis in original).

[12] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 38.

[13] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 48 (emphasis added).

[14] *United States v. Solomon*, 570 F. Supp. 3d 1195 (S.D. Florida 2021); "Individual Waived Statute of Limitations for FBAR Penalties, 2021 Tax Notes Today International 212-18 (Oct. 27, 2021).

[15] *United States v. Solomon*, U.S. District Court, Southern District of Florida, Case 9:20-cv-82236, Defendant's Motion for Partial Summary Judgment and Memorandum of Law (Feb. 1, 2021), pg. 7.

[16] *United States v. Solomon*, 570 F. Supp. 3d 1195, 1201 (S.D. Florida 2021).

[17] *United States v. Solomon*, 570 F. Supp. 3d 1195, 1201 (S.D. Florida 2021). Some commentators have criticized the decision in this case, primarily because of the inconsistent positions taken by the government with respect to the jurisdictional issue. *See* Keith Fogg, "IRS Succeeds in Jurisdictional Argument, With a Twist," Tax Notes (Nov. 4, 2021).

[18] *United States v. Herscovici*, U.S. District Court, Central District of California, Case 2:21-cv-06150.

[19] *United States v. Herscovici*, U.S. District Court, Central District of California, Case 2:21-cv-06150, Civil Minutes regarding Second Motion for Default Judgment (May 16, 2022), pg. 9.

[20] *United States v. Sinyavskiy*, U.S. District Court, Eastern District of New York, Case 1:21-cv-02757.

© 2024 Thomson Reuters

[21] *United States v. Sinyavskiy*, U.S. District Court, Eastern District of New York, Case 1:21-cv-02757, Report and Recommendation (July 29, 2022); Tax Notes Doc. 2022-25160.

[22] *United States v. Rund*, U.S. District Court, Eastern District of Virginia, Case 1:23-cv-00549, Memorandum and Order (August 6, 2024); "FBAR Penalties Apply Despite Reliance on Advisors," Tax Notes Doc. 2024-22794.

[23] *United States v. Schwarzbaum*, U.S. Court of Appeals, Eleventh Circuit, Case No. 22-14058, Opinion (August 30, 2024); "FBAR Penalties Can Be Excessive Fines, Eleventh Circuit Holds," Tax Notes Doc. 2024-25149; Amanda Athanasiou, "Schwarzbaum FBAR Penalty Dispute Results in Circuit Split," 2024 Tax Notes Today 169-2 (Sept. 3, 2024).

[24] *United States v. Schwarzbaum*, U.S. Court of Appeals, Eleventh Circuit, Case No. 22-14058, Opinion (August 30, 2024), pgs. 24-25.

[25] *See United States v. Toth*, 33 F.4th 1 (1st Cir. 2022).

[26] *United States v. Schwarzbaum*, U.S. Court of Appeals, Eleventh Circuit, Case No. 22-14058, Opinion (August 30, 2024), pg. 25.

[27] *United States v. Schwarzbaum*, U.S. Court of Appeals, Eleventh Circuit, Case No. 22-14058, Opinion (August 30, 2024), pg. 29.

[28] *United States v. Schwarzbaum*, U.S. Court of Appeals, Eleventh Circuit, Case No. 22-14058, Opinion (August 30, 2024), pg. 31.

[29] *United States v. Schwarzbaum*, U.S. Court of Appeals, Eleventh Circuit, Case No. 22-14058, Opinion (August 30, 2024), pg. 45.

© 2024 Thomson Reuters

ARGENTINA ENACTS BASES LAW AND TAX PACKAGE

On 8 July 2024, the Argentine Government enacted Laws No. 27,742 ("Law of Bases and Starting Points for Argentine's Freedom" in English) and No. 27,743 (Fiscal Package Law or "Palliative and Relevant Tax Measures" in English) through publication in the *Official Gazette.*

Law No. 27,742 ("Ley Bases" in Spanish) declares the public emergency in administrative, economic, financial and energy matters, and delegates legislative powers to the Executive Branch for one year.

Among the main changes established by this law are:

- Labor modernization
- Special Incentive Regime for Large Investments ("RIGI" in Spanish)
- State Reform (Administrative Reorganization, Privatization and Modification of Public Employment Law)
- Reform of the Administrative Procedures Law No. 19,549
- Concessions
- Energy
- Contracts and transactional agreements

Law No. 27,743 (Fiscal Package Law or Tax Package) establishes the following measures and modifications in tax matters:

- Exceptional Regularization Regime ("Moratoria" in Spanish) for Tax, Customs and Social Security Obligations due until 31 March 2024, inclusive
- Asset Regularization Regime ("Blanqueo" in Spanish)
- Reduction in Personal Assets Tax from fiscal year 2023 and onward, and optional special tax advance regime for five fiscal years
- Increases in personal deductions and changes in the scale of Income tax for individuals, applicable from fiscal year 2024, and certain adjustments for fiscal year 2023
- Increase in the thresholds of the various categories of the Simplified Tax Regime for Small Taxpayers ("Monotributo" in Spanish), effective since January 2024

Ana Mingramm, Enrique Perez Grovas, Pablo Wejcman and Maria Melina Oyhenart (New York – EY Americas Tax)

ARGENTINA ENACTS NEW INCENTIVE REGIME FOR LARGE INVESTMENTS

As part of the "Bases Law" promulgated on 8 July 2024, through Law No. 27,742, Argentina has enacted a new incentive regime for large investments ("*Régimen de Incentivo para Grandes Inversiones*" or RIGI).

The purpose of the RIGI is to give those who commit to executing large investments, within a certain period of time, a degree of predictability, stability, legal certainty and protection for acquired rights in tax, customs and foreign exchange matters.

The RIGI applies on investments destined to the following sectors:

- Forestry and associated industries ("*forestoindustrias*" in Spanish)
- Tourism
- Infrastructure
- Mining
- Technology
- Steel industry
- Energy
- Oil and gas

The RIGI's main objectives are to: encourage large national and foreign investments in Argentina; promote economic development; develop and strengthen the competitiveness of the different sectors; increase exports of goods and services abroad; promote job creation; and generate immediate predictability and stability conditions for the large investments, among others.

The RIGI will be available for two years from the date it was published in the *Official Gazette* (i.e., will be open until 8 July 2026); the Executive Branch may extend that deadline for one more year.

The RIGI will apply to Sole Purpose Vehicles (SPV) ("*Vehículos de Proyecto Unico*" or VPU) owners of projects that qualify as "Large Investments" under the terms of the regime.

The following entities shall be considered VPUs:

1. Corporations (*Sociedades Anonimas/ Sociedades Anonimas Unipersonales*) and Limited liability companies (*Sociedades de Responsabilidad Limitada*)
2. Branches established by companies incorporated abroad
3. Dedicated branches — e.g., if an entity wants to adhere to the RIGI and develops one or more activities that will not be part of the investment project, or has one or more assets that will not be allocated to the project, it may opt to establish a branch office solely for purposes of participating in the RIGI
4. Joint ventures (*Uniones Transitorias*) and other associative contracts

Requirements and characteristics of the investment plan

To comply with the requirements of the RIGI, SPVs must submit an application and an investment plan and obtain the approval of the Application Authority. The project must involve a "Large Investment."

Projects will be considered "Large investments" if they meet both of the following requirements:

- Involve the acquisition, production, construction and/or development of assets to be used for activities of the sectors included in the RIGI, and involve an investment in computable assets of at least US$200m (the Executive Branch may increase this limit to US$900m for certain type of investments)
- Provide for the first and second year a minimum investment in computable assets as established by the Executive Branch that is not lower than 40% of the minimum investment committed

Investments must be of a long-term nature and will be considered long-term if they have a ratio of no more than 30% between the present value of expected net cash flow — excluding investments — and the net present value of the investments during the first three years.

Investments in computable assets are those used to acquire, produce, construct and/or develop assets that will be used for activities in the sectors included in the RIGI. The acquisition of shares, real estate, rights

© 2024 Thomson Reuters