BY STEVEN TOSCHER AND LACEY STRACHAN

Proving Wilfullness in Civil FBAR Cases

SINCE 2003, THE IRS HAS had the authority to enforce compliance with the foreign bank account reporting requirements of the Bank Secrecy Act.[1] Only recently, however, have practitioners been getting guidance from the courts regarding the fundamental issue of what the government must prove to establish willfulness and sustain the penalty for the willful failure to file what is commonly known as the FBAR form.

Officially designated Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts, the FBAR is filed with the Department of the Treasury and discloses that the filer has a financial interest in, or signatory authority over, one or more financial accounts in a foreign country with an aggregate value exceeding $10,000 at any time during the taxable year.[2] The few reported cases dealing with the failure to file the FBAR have been criminal cases. There has been little if any litigation regarding the imposition of civil FBAR penalties. That has now changed with international tax enforcement matters becoming a priority for both the IRS and the Department of Justice, Tax Division. The Fourth Circuit's recent unpublished decision in *United States v. Williams* and the recent district court decision from the Tenth Circuit in *United States v. McBride* raise a number of important questions in analyzing a taxpayer's exposure to the civil penalty for willfully failing to file an FBAR.[3] This is important, given what some say is a draconian civil penalty for the willful failure to file the FBAR form. *Williams* is unpublished, and *McBride* is a district court decision, so neither case is binding, but they offer guidance on what proves willfulness.

The Civil FBAR Penalty

The obligation to file an FBAR is part of the Bank Secrecy Act and is set forth in 31 USC Section 5314, which requires "a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency."[4] The civil penalty for failure to file the FBAR has been in the law since 1986.[5]

In 2004, Congress increased the maximum penalty for the willful failure to file the form from $100,000 to up to 50 percent of the balance in the account at the time of the violation, which is the due date of the FBAR.[6] The position of the IRS is that this penalty applies to each unreported account, not to each unfiled FBAR, for each year for which there was no FBAR filed.[7] Although agents are expected to exercise discretion in imposing FBAR penalties, this creates the potential for an FBAR penalty that is many times the value of the foreign account.[8]

This maximum penalty only applies if the taxpayer's failure to file an FBAR was willful—Congress has enacted a penalty of up to $10,000 per violation for cases in which the taxpayer was nonwillful.[9] As a result, a critical inquiry in a civil FBAR case brought by the government is whether the failure to comply with the FBAR requirements was willful.

RICHARD EWING

The Fourth Circuit's decision in *Williams* and the district court's in *McBride* analyze some important questions concerning the government's obligation to prove willfulness in a civil FBAR case. These issues include 1) the government's ability to establish willfulness by proving recklessness, 2) the government's ability to prove willfulness by demonstrating willful blindness, and 3) the government's burden of proof in a civil FBAR case.

Prior to the Fourth Circuit's decision in *Williams* and the district court decision in *McBride,* the general consensus was that the government would encounter substantial difficulties in being able to demonstrate that the failure to file the FBAR form was willful. In a Chief Counsel Office Memorandum (CCA) released in 2006, the IRS concluded the willful standard in the civil context has the same meaning and interpretation as the willful standard under the criminal penalty statute.[10]

In 2010, the District Court for the Eastern District of Virginia held in *Williams* that the government failed to meet its burden of establishing that the defendant had willfully failed to disclose his assets in

Steven Toscher is a principal, and Lacey Strachan is an associate, at Hochman Salkin Rettig Toscher and Perez, were they specialize in civil and criminal tax controversy and litigation.

a foreign account.[11] However, this decision was overturned by the Fourth Circuit in an unpublished opinion, finding that the lower court clearly erred in concluding that Williams had not willfully failed to file an FBAR.[12] The Fourth Circuit was convinced that, "at a minimum, Williams's undisputed actions establish reckless conduct, which satisfies the proof requirement under Section 5314."[13]

The Fourth Circuit's decision in *Williams* was followed by the District Court for the District of Utah in *McBride*. The court in *McBride* found that McBride had an FBAR reporting requirement and willfully failed to comply with it.[14] Similar to *Williams,* the court in *McBride* concluded that McBride was at least reckless or willfully blind of his FBAR reporting obligations.[15]

When one reads the facts of *Williams* and *McBride,* it becomes clear that the evidence of willful tax misconduct was overwhelming. The court's discussion of a lesser standard of proof, such as recklessness or willful blindness, was not necessary for these decisions and could be properly construed as dictum. Nevertheless, the court's discussion of these issues is important. The decisions reflect a typical government litigation strategy, which is to establish principles of law with egregious factual patterns and then attempt to apply the favorable law to less egregious situations.

Facts of *Williams* and *McBride*

It is important in analyzing these issues to understand the facts of the *Williams* and *McBride* cases so the court's decisions and statements regarding the principles of law can be placed into an appropriate context. In *Williams,* the government brought the FBAR case after Williams had already pleaded guilty to conspiracy and tax evasion related to two Swiss bank accounts that he held in the name of a British corporation holding more than $7 million.[16] In his allocution, Williams admitted he chose to not report the income from the foreign accounts on his returns for the purpose of evading taxes.[17] He further stated that he knew that he had the obligation to report the Swiss accounts to the IRS or the Department of the Treasury and chose not to in order to assist in hiding his income from the IRS.[18]

The IRS subsequently assessed an FBAR penalty against Williams for the year 2000 and brought a civil action to collect the penalty.[19] In early 2001, after the government had already become aware of Williams's accounts and had them frozen, Williams nonetheless marked a box answering no on a tax organizer that he completed for his accountant in response to the question regarding whether he had an interest in a foreign account.[20] The same box was also checked in response to question 7a on Schedule B of his Form 1040 filed for tax year 2000, and Williams did not file an FBAR for the year 2000 by the deadline.[21]

Williams used the fact that the government was already aware of the accounts at that time to convince the district court that he did not intend to conceal the accounts from the IRS in 2000.[22] He testified at trial that he was not aware of the FBAR form and that he focused on only the numerical calculations on his return.[23] Finding Williams to be credible, the district court entered judgment in his favor.[24]

On appeal, because Williams had admitted in his plea allocution that he knew he had to report the accounts to the government and chose not to, and because he had signed his return containing Schedule B under penalty of perjury, the Fourth Circuit held that the district court clearly erred in finding that the government had not met its burden of proving that his failure to file an FBAR was willful.[25] Circuit Judge G. Steven Agee dissented from the opinion and stated that he would have affirmed the lower court's decision, noting that there was no mention of the Section 5314 reporting requirements or the FBAR in Williams's allocution, and the district court judge had found Williams's testimony to be credible.[26]

In *McBride,* the taxpayer set up a complex financial scheme with the help of a financial management firm, through which approximately $2.7 million in profits of a company he co-owned were funneled through the company's Taiwanese manufacturer to nominee offshore companies and financial accounts.[27] The district court found that the offshore companies and financial accounts were established for the benefit of and were controlled by McBride.[28] The taxpayer then funneled the funds back to himself through a sham line of credit from the entities and benefited from the funds by directing that they be used for personal uses.[29] Merrill Scott, the financial management firm retained by McBride, held itself out as a financial management firm that employed strategies that would allow its clients to avoid or defer the recognition of income for tax purposes and protect client assets from creditors.[30]

McBride stated under penalty of perjury that he read a pamphlet that Merrill Scott provided to him that included the following:

> 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.…Intentional failure to comply with the foreign account reporting rule is a crime and the IRS has means to discover such unreported assets.[31]

However, McBride failed to file an FBAR reporting the account and question 7a on Schedule B of his Forms 1040 were marked no.[32] McBride never informed the accountant who prepared his 2000 tax return about the foreign accounts, because he "thought that was the purpose of Merrill Scott because…if you disclose the accounts on the form, then you pay tax on them, so it went against what [he] set up Merrill Scott for in the first place."[33]

McBride proceeded to lie to the government during the IRS investigation stemming from his participation in Merrill Scott programs. He even denied during an IRS interview that he had utilized the offshore components set up by Merrill Scott and denied knowledge of any wire transfer from the offshore accounts.[34] The IRS assessed a civil FBAR penalty for 2000 and 2001 relating to four offshore financial accounts held on behalf of McBride.[35] Finding that McBride's failure to file an FBAR was willful, the district court entered a judgment against him.[36]

The Willfulness Standard

In the criminal context, the definition of willfulness that has developed is a voluntary, intentional violation of a known legal duty. *United States v. Sturman* upheld the defendant's criminal conviction on a count of willfully failing to maintain records and file reports as required under Section 5314.[37] The court defined the willfulness standard as a "voluntary, intentional violation of a known legal duty," citing the tax case *Cheek v. United States,*[38] and explained that "[w]illfulness may be proven through inference from conduct meant to conceal or mislead sources of income or other financial information."[39]

This definition is consistent with the IRS definition of willfulness in both the civil and criminal contexts. The *Internal Revenue Manual* states that, for application of the civil FBAR willfulness penalty, "the test for willfulness is whether there was a voluntary, intentional violation of a known legal duty."[40] The manual further explains that willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements.[41] The only thing that a person need know is that he or she has an FBAR reporting requirement.[42] If a person has that knowledge, the only intent needed to constitute a willful violation of the requirement is a conscious choice not to file the FBAR.[43]

Williams and *McBride* conclude that the willfulness standard can include willful blindness to the FBAR requirement. This position is consistent with the IRS definition of willfulness for purposes of the civil FBAR penalty. The *Internal Revenue Manual* explains that "willfulness may be attributed to a person who has made a conscious effort to avoid

learning about the FBAR reporting and recordkeeping requirements."[44]

The willful blindness charge in criminal cases originates from *United States v. Jewell,* a controlled substance case that held that "deliberate ignorance and positive knowledge are equally culpable."[45] In *United States v. Stadtmauer,*[46] the court concluded that the general rule that willful blindness may satisfy a knowledge requirement applies in criminal tax prosecutions.[47]

Willful blindness is a high bar to meet. To constitute willful blindness, the taxpayer must intentionally avoid or deliberately evade learning of his or her tax obligations. It is a state of mind of "much greater culpability than simple negligence or recklessness, and more akin to knowledge."[48]

Recklessness

Departing from the IRS's definition of willfulness, *Williams* and *McBride* hold that the definition of willful in the civil context is different from the definition of willful in the criminal context. Both cases conclude that the willfulness standard in a civil case may be satisfied by recklessness.[49] Despite making findings supporting that the taxpayers had knowledge of the Section 5314 reporting requirements or were willfully blind of their reporting requirements, both courts concluded that the taxpayers were willful on the basis that their conduct was at a minimum reckless.[50]

The court in *Williams* relied on *Safeco Insurance Company of America v. Burr* in determining that the willfulness requirement in the FBAR statute may be satisfied by reckless conduct. In defining the standard for willfulness, the *Williams* court stated, "Importantly, in cases 'where willfulness is a statutory condition of civil liability, [courts] have generally taken it to cover not only knowing violations of a standard, but reckless ones as well.'"[51]

The Supreme Court in *Safeco Insurance* interpreted willfulness in the context of the Fair Credit Reporting Act and noted that "'willfully' is a word of many meanings whose construction is often dependent on the context in which it appears."[52] In defining willfulness to include recklessness in the FBAR context, the courts' decisions are inconsistent with long-established precedent defining willfulness in tax and Bank Secrecy Act cases,[53] and with the IRS position as expressed in the CCA and the *Internal Revenue Manual*.

The CCA released by the IRS concluded, based on rules of statutory construction, that "willful" has the same meaning in the civil context as it has in the criminal context—a voluntary intentional violation of a known legal duty.[54] The IRS concluded that because the same word—"willful"—is used in Section 5321(a)(5) (the civil penalty for violating section 5314) and Section 5322(a) (the criminal penalty for violating section 5314), "willful" should have the same meaning under both sections based on the statutory construction rule that "the same word used in related sections should be consistently construed."[55]

The Supreme Court has stated that the definition of "willful" depends on the context in which it appears. Congress has chosen to impose the same intent requirement for the civil FBAR penalty as for the criminal FBAR penalty. The context here makes clear that "willful" means a voluntary intentional violation of a known legal duty and not any lesser standard.

The Burden of Proof

In most tax cases, the assessment of the IRS of additional taxes is presumed to be correct, and the burden is placed upon the taxpayer to demonstrate that the IRS is incorrect. However, penalties—especially penalties involving willfulness—occupy a different category, and the burden has fallen on the IRS to prove that the taxpayer is subject to penalties for willfulness.

The IRS took the position in its CCA of January 20, 2006, that it expects 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.'" In reaching this conclusion, the IRS compared the burden of proof for the civil FBAR penalty with the burden of proof for the civil fraud penalty under Code Section 6663, because both penalties require the government to prove a taxpayer's intent. Courts have established that civil tax fraud must be proven by clear and convincing evidence.[56]

The recent *Williams* and *McBride* decisions have impressed a less onerous burden on the government and require the government to prove willfulness for civil purposes by only a preponderance of evidence.[57] The court in *McBride* held that preponderance of the evidence is the correct standard of proof because "particularly important individual interests or rights" are not at stake in civil FBAR penalty cases, given that the penalties at issue only involve money.[58] The court explained that in such cases, the preponderance of the evidence standard applies unless a statute states otherwise. However, although the civil FBAR penalty is only a monetary penalty, *McBride* fails to consider that the FBAR penalty can be disproportionate compared to the conduct—the potential severity of the penalty should exact a higher standard of proof.[59]

The court in *McBride* ignores the burden of proof in the analogous civil tax fraud penalty cases, which is established by case law to be clear and convincing evidence even though the civil tax fraud penalty involves only money. The rationale for the higher burden of proof in civil penalty cases involving a question of intent is well explained by the IRS in its CCA. The IRS reasons that the higher burden of proof is appropriate in such cases because "just as it is difficult to show intent, it is also difficult to show a lack of intent."[60] The clear and convincing evidence standard "offers some protection for an individual who may be wrongly accused of fraud."[61] For the same reason, it is important for this higher burden of proof to be applied in civil FBAR cases, especially given the draconian nature of the civil FBAR penalty.

Signing the Return

A critical question raised by the willfulness standard is what constitutes knowledge of the FBAR reporting requirements. In *Williams,* the court applied the rule that a taxpayer's signature on a return is "prima facie evidence that the signer knows the contents of the return,"[62] in order to establish that the taxpayer had constructive knowledge of the FBAR requirements because Schedule B of a Form 1040 contains a question asking whether the taxpayer has a financial interest in a foreign account and directs the taxpayer to see the instructions for the FBAR filing requirements. The court in *Williams* reasoned that because Williams signed a Form 1040 with a Schedule B under penalty of perjury but never consulted a Form TD F 90-22.1, his conduct constituted willful blindness to the FBAR requirement.

The court in *Williams* cited *United States v. Mohney* in support of this conclusion. In *Mohney,* the court in fact held that while the signature is prima facie evidence that the signer knows the contents of the return, a taxpayer's signature on a return "does not in itself prove his knowledge of the contents"—only that knowledge may be inferred from the signature along with the surrounding facts and circumstances.[63] Consistent with this rule, the IRS' position, as set forth in the *Internal Revenue Manual*, is 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."[64] Most taxpayers do not read their return carefully, especially language on a schedule that does not relate to any numbers on their return.

Contrary to the IRS's position, and inconsistent with established case law on defining willfulness in the tax and FBAR contexts, the district court in *McBride* took the position that in civil FBAR penalty cases, signing a return with a Schedule B is enough to constitute knowledge of the FBAR reporting

requirements, even absent surrounding facts and circumstances and regardless of whether the taxpayer actually read the return.[65] *McBride* distinguished *Mohney* on the basis that *Mohney* applies only to the *contents* of a return, not to the instructions contained within the return.[66] The court in *McBride* concluded that it is only in criminal cases in which ignorance of the law is a defense to willfulness—in the civil context, the court stated that the well-established legal principle that citizens are charged with knowledge of the law applies.[67]

However, the civil FBAR penalty is a specific intent penalty. The judge's conclusion in *McBride* essentially renders meaningless the willfulness element of the civil FBAR penalty. If all taxpayers are charged with knowledge of the FBAR reporting requirements for purposes of the penalty under Section 5321(a)(5), all that the government would need to prove to impose the willful penalty is that the taxpayer's failure to file an FBAR was voluntary. This view is clearly contrary to the intent of Congress in enacting the civil FBAR penalty and requiring specific intent.

The *Williams* and *McBride* decisions do not substantially alter the analysis of the types of cases in which the willful penalty will apply, but the dicta in the cases, which suggest that a recklessness standard may apply and impose a lesser burden of proof on the government, will no doubt fuel the government to be more aggressive in selection of the cases that it proceeds with on a willfulness penalty. That, unfortunately, is the way of the common law, and ultimately the courts will find the right balance based upon the facts of the individual cases. However, for now, practitioners should anticipate a more aggressive government stance on the imposition of the willful FBAR penalty. ■

---

[1] 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 (USA Patriot Act), Exhibit C, Secretary of the Treasury (Apr. 24, 2003).

[2] The 2012 Form TD F 90-22.1 and instructions are available at http://www.irs.gov/pub/irs-pdf/f90221.pdf.

[3] United States v. Williams, 2012 U.S. App. LEXIS 15017 (4th Cir. 2012); United States v. McBride, 2012 U.S. Dist. LEXIS 161206 (D. Utah 2012).

[4] 31 U.S.C. §5314(a).

[5] Pub. L. No. 99–570, tit. 1, §§1356(c)(1), 1357(a)–(f), (h) (Oct. 27, 1986).

[6] 31 U.S.C. §5321(a)(5)(C); Internal Revenue Manual 4.26.16.4.5 (July 1, 2008) [hereinafter I.R.M.].

[7] I.R.M. 4.26.16.4.7 (July 1, 2008).

[8] *See* FAQ #8, Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers, *available at* http://www.irs.gov/Individuals/International-Taxpayers-/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers (showing how a $3,825,000 FBAR penalty could apply to a bank account opened with $1,000,000 in 2003). *See also* Steven Toscher & Barbara Lubin, *When Penalties Are*

Excessive—The Excessive Fines Clause as a Limitation to the Imposition of the Willful FBAR Penalty, J. OF TAX PRACTICE & PROCEDURE (Dec. 2009-Jan. 2010).
[9] 31 U.S.C. §5321(a)(5)(B)(i).
[10] C.C.A. 2006-03-026 (Jan. 20, 2006).
[11] United States v. Williams, 2010 U.S. Dist. LEXIS 90794 (E.D. Va. 2010).
[12] United States v. Williams, 2012 U.S. App. LEXIS 15017, at *14 (4th Cir. 2012).
[13] *Id.*
[14] United States v. McBride, 2012 U.S. Dist. LEXIS 161206, at *42 (D. Utah 2012).
[15] *Id.*
[16] Williams, 2012 U.S. App. LEXIS 15017, at *3-5.
[17] *Id.* at *6-7.
[18] *Id.*
[19] *Id.* at *7.
[20] *Id.* at *3-4.
[21] *Id.* at *4.
[22] *See id.* at *8.
[23] *See* United States v. Williams, 2010 U.S. Dist. LEXIS 90794, at *16-17 (E.D. Va. 2010).
[24] *See id.*
[25] *See* United States v. Williams, 2012 U.S. App. LEXIS 15017, at *10-15 (4th Cir. 2012).
[26] *Id.* at *15-23.
[27] *See* United States v. McBride, 2012 U.S. Dist. LEXIS 161206, at *2-34 (D. Utah 2012).
[28] *See id.* at *41-44.
[29] *See id.* at *17-21.
[30] *See id.* at *3-6.
[31] *Id.* at *8.
[32] *Id.* at *27-28.
[33] *Id.* at *31.
[34] *Id.* at *32-34.
[35] *Id.* at *33-34.
[36] *Id.* at *75-76.
[37] United States v. Sturman, 951 F. 2d 1466 (6th Cir. 1991).
[38] Cheek v. United States, 498 U.S. 192 (1991).
[39] Sturman, 951 F. 2d at 1476 (citing Spies v. United States, 317 U.S. 492 (1943)).
[40] I.R.M. 4.26.16.4.5.3 at ¶1 (July 1, 2008). *See also* C.C.A. 2006-03-026 (Jan. 20, 2006).
[41] I.R.M. 4.26.16.4.5.3 at ¶5 (July 1, 2008).
[42] *Id.*
[43] *Id.*
[44] I.R.M. 4.26.16.4.5.3 at ¶6 (July 1, 2008).
[45] United States v. Jewell, 532 F. 2d 697, 700 (9th Cir. 1976).
[46] United States v. Stadtmauer, 620 F. 3d 238 (3rd Cir. 2010).
[47] *Id.* at 256; *see also* United States v. Anthony, 545 F. 3d 60, 64-65 (1st Cir. 2008) (explaining that deliberate avoidance undermines a claim of good faith); United States v. Dean, 487 F. 3d 840, 851 (11th Cir. 2007) (A jury instruction of willful blindness is appropriate when the defendant "intentionally insulated himself from knowledge of his tax obligations.").
[48] Stadtmauer, 620 F. 3d at 256 (quoting United States v. One 1973 Rolls Royce, 43 F. 3d 794, 808 (3d Cir. 1994)).
[49] United States v. Williams, 2012 U.S. App. LEXIS 15017, at *10 (4th Cir. 2012); United States v. McBride, 2012 U.S. Dist. LEXIS 161206, at *46-47, *60-62 (D. Utah 2012).
[50] Williams, 2012 U.S. App. LEXIS 15017, at *10; McBride, 2012 U.S. Dist. LEXIS 161206, at *15.
[51] United States v. Williams, 2012 U.S. App. LEXIS 15017, at *10 (4th Cir. 2012) (quoting Safeco Ins. Co. of Am. v. Burr, 551 U.S. 47 (2007)).
[52] Safeco Ins. Co. of Am. v. Burr, 551 U.S. 47, 57 (2007).
[53] *See*, *e.g.,* Ratzlaf v. United States, 510 U.S. 135 (1994).
[54] C.C.A. 2006-03-026 at 2 (Jan. 20, 2006).
[55] *Id.*
[56] Bradford v. Commissioner, 796 F. 2d 303, 307 (9th Cir. 1986); Stone v. Commissioner, 56 T.C. 213, 220 (1971). In criminal cases, the standard of proof is beyond a reasonable doubt.
[57] United States v. McBride, 2012 U.S. Dist. LEXIS 161206, at *2-34 (D. Utah 2012). Although it was not discussed in the appellate opinion, the district court in *Williams* had applied a preponderance-of-the-evidence standard. United States v. Williams, 2010 U.S. Dist. LEXIS 90794, at *17 (E.D. Va. 2010). The court did not state its reasoning for applying a preponderance-of-the-evidence standard, but a higher burden of proof would not have changed the lower court's decision, because the lower court held that the government had not met even a preponderance-of-the-evidence standard.
[58] United States v. McBride, 2012 U.S. Dist. LEXIS 161206, at *37 (D. Utah 2012).
[59] For a discussion on the FBAR penalty and the Excessive Fines Clause of the Eighth Amendment, *see* Steven Toscher & Barbara Lubin, *When Penalties Are Excessive—The Excessive Fines Clause as a Limitation to the Imposition of the Willful FBAR Penalty,* J. OF TAX PRACTICE & PROCEDURE (Dec. 2009-Jan. 2010).
[60] C.C.A. 2006-03-026 at 3 (Jan. 20, 2006).
[61] *Id.*
[62] United States v. Mohney, 949 F. 2d 1397, 1407 (6th Cir. 1991); United States v. Dehlinger, 368 Fed. Appx. 439, 447 (4th Cir. 2010).
[63] Mohney, 949 F. 2d at 1407.
[64] I.R.M. 4.26.16.4.5.3 at ¶6 (July 1, 2008).
[65] *See* United States v. McBride, 2012 U.S. Dist. LEXIS 161206, at *52-57 (D. Utah 2012).
[66] *Id.*
[67] *Id.*