

# Practice

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## Jury Determines 150-Percent FBAR Penalty and U.S. Seeks FBAR Related Forfeiture of \$12 Million!

*By Charles P. Rettig*

**T**axpayers participating in the ongoing IRS Offshore Voluntary Disclosure Program (OVDP)<sup>1</sup> generally agree to file amended returns and file Report of Foreign Bank and Financial Accounts (FinCEN Form 114, formerly Form TD F 90-22.1), commonly referred to as the “FBAR,” for eight tax years, pay the appropriate taxes and interest together with an accuracy-related penalty equivalent to 20 percent of any income tax deficiency and an “FBAR-related” penalty (in lieu of all other potentially applicable penalties associated with a foreign financial account or entity) of 27.5 percent of the highest account value that existed at any time during the prior eight tax years.

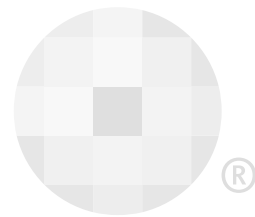
The IRS OVDP is ongoing and does not have a stated expiration date, but it can be terminated by the IRS at any time either entirely or as to specific classes of taxpayers. The decision whether to participate in the ongoing IRS OVDP as opposed to possibly pursuing some other method of coming into compliance must take into account all relevant facts and circumstances as well as the possibility of expansive IRS discretion to perform examinations over a lengthy period of time outside the OVDP. Long-term residents of the United States might be deemed to have a higher degree of knowledge and might be treated differently than long-term nonresidents of the United States.

Certainly, all taxpayers are anything but equally culpable with respect to issues relating to the filing and reporting requirements involving foreign financial accounts. Overall, IRS examinations of taxpayers outside the confines of the OVDP have progressed in a somewhat reasonable manner. The fairness in the resolution often depends on the actual facts involved. However, the government continues to assert that those who are discovered disclosing offshore accounts outside of the OVDP risk more significant civil penalties, depending on the facts and circumstances of their cases.

### Income Tax Reporting

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Citizens and residents of the United States who have income in any one calendar year in excess of a threshold amount (“U.S. taxpayers”) are obligated to file a U.S.



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Individual Income Tax Return Form 1040 (“Form 1040”), for that calendar year with the IRS. Form 1040 requires U.S. taxpayers to report their income from any source, regardless of whether the source of their income is inside or outside the United States.

In addition, on Schedule B of Form 1040, the filer must indicate whether “at any time during [the relevant calendar year]” the filer had “an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account.” If the U.S. taxpayer answers that question in the affirmative, then the U.S. taxpayer must indicate the name of the particular country in which the account is located.

## BSA Filing Requirements

Under the Bank Secrecy Act, U.S. taxpayers who have a financial interest in, or signature authority over, a financial account in a foreign country with an aggregate value of more than \$10,000 at any time during a particular calendar year are required to file an FBAR. The FBAR for any calendar year is required to be filed on or before June 30 of the following calendar year.

In general, the FBAR requires that the U.S. taxpayer filing the form identify the financial institution with which the financial account is held, the type of account (bank, securities or other), the account number, and the maximum value of the account during the calendar year for which the FBAR is being filed.

Taxpayers comply with their U.S. filing requirements by both noting the account on their income tax return *and* by filing the FBAR. Civil penalties for *willful* failure to comply with the FBAR reporting requirements of 31 U.S.C. § 5314 can be imposed under 31 U.S.C. § 5321(a)(5). For violations involving the *willful* failure to report the existence of an interest in a foreign account, the maximum amount of the penalty that may be assessed under Section 5321(a)(5) is the greater of \$100,000 or 50 percent of the balance in an unreported foreign account, *per year*, for up to six tax years.

“Willfulness” generally requires the government prove the failure to file was as a result of a “voluntary, conscious and intentional” act by the taxpayer. Taxpayers should carefully review the recent court decisions in *Williams*<sup>2</sup> and *McBride*<sup>3</sup> on the issue of determining “willfulness” for assertion of the more significant “willful” FBAR penalties (of up to 50 percent of the account balance, per year).

Although the underlying facts in *Williams* and *McBride* were not the best, the courts might not lightly view those with considerable financial resources who fail to inquire

about their potential reporting requirements associated with various interests in foreign financial accounts. The IRS Internal Revenue Manual suggests that “willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements.”

An “undeclared account” is a financial account maintained outside the United States and beneficially owned by a U.S. taxpayer, but that is not disclosed to the IRS on Schedule B of Form 1040, Form 8938 or on an FBAR, and any income generated in the account was not reported to the IRS on Form 1040.

## C.R. Zwerner

On June 11, 2013, the U.S. government filed a Complaint to collect *multiple 50-percent civil FBAR penalties* in the aggregate amount of \$3,488,609.33 previously assessed against Carl R. Zwerner of Coral Gables, Florida for his alleged failure to timely report his financial interest in a foreign bank account, as required by 31 U.S.C. § 5314 and its implementing regulations.<sup>4</sup> According to the *Zwerner* complaint, from 2004 through 2007, Mr. Zwerner, a U.S. citizen, had a financial interest in an account at ABN AMRO Bank in Switzerland (hereinafter, “the Swiss bank account”).

Mr. Zwerner is an 87-year-old man who authorized his tax counsel in 2008 to contact IRS Criminal Investigation and make a voluntary disclosure. Mr. Zwerner disclosed the existence of his offshore account (including income generated by the account) on his timely filed 2007 tax return and paid the tax owed.

On February 10, 2009, Mr. Zwerner’s prior tax counsel contacted IRS Criminal Investigation Division (CID) on a hypothetical basis (without disclosing the identity of Mr. Zwerner). On February 17, 2009, IRS CID issued a letter stating that no criminal action would take place, but the identity of the client had not been disclosed at the February 10, 2009 meeting. Mr. Zwerner was then advised by his tax counsel that his voluntary disclosure had occurred and he should file the amended returns for tax years 2004, 2005 and 2006. On or about March 27, 2009, Mr. Zwerner filed amended tax returns and the FBARs for 2004, 2005 and 2006, and paid the tax and interest owing.

Mr. Zwerner’s tax returns were not under audit at the time of his voluntary disclosure. Following up on this traditional voluntary disclosure, at some point in 2010 the IRS began an audit of Mr. Zwerner’s returns. In the course of that audit, Mr. Zwerner advised the IRS agent of his prior voluntary disclosure.

Mr. Zwerner appears to have come into compliance under the then applicable voluntary disclosure practice set for in the IRS's Internal Revenue Manual 9.5.11.9, Example 6(A) at a time when there was no formal program regarding the voluntary disclosure of previously undisclosed interests in offshore financial accounts. Unfortunately, IRM 9.5.11.9 only speaks to the voluntary disclosure being a factor considered by the IRS in the determination of a referral for criminal prosecution by the Tax Division of the U.S. Department of Justice. It has no formal impact on any IRS civil penalty determination although, historically, a timely voluntary disclosure has received favorable consideration in the civil penalty arena as well.

The Zwerner Complaint alleges that the balance of the Swiss bank account from 2004–2007 was at all times greater than \$10,000 and that, as such, on or before June 30 of each succeeding year, Mr. Zwerner was required to file an FBAR reporting his financial interest in the Swiss bank account. Accordingly, the government assessed penalties against Mr. Zwerner under 31 U.S.C. § 5321(a)(5) in the amount of 50 percent of the balance of his account at the time of the violations for each year, as follows: (1) 2004 – \$723,762, assessed on June 21, 2011; (2) 2005 – \$745,209, assessed on August 10, 2011; (3) 2006 – \$772,838, assessed on August 10, 2011; and (4) 2007 – \$845,527 assessed on August 10, 2011.

In *Zwerner*, the government assessed civil FBAR penalties equivalent to 50 percent of the highest account balance for each of tax year 2004, 2005, 2006 and 2007, aggregating \$3,488,609.33 for an account that appears to have had a high balance of \$1,691,054 during the relevant time period! The IRS asserted a 75-percent civil income tax fraud penalty for tax years 2004, 2005 and 2006. Following the audit, the income tax civil fraud penalty was abated in the U.S. Tax Court for 2006, by IRS Appeals for 2004 and 2005, and was not even asserted by the IRS for 2007.

## Jury Determines 150-Percent FBAR Penalty Applies!

The jury trial in *Zwerner* began on May 19, 2014, in the Federal District Court for the Southern District of Florida. Today, the jury returned a verdict finding Mr. Zwerner “willful” and thus liable for an FBAR penalty equivalent to 50 percent of the high balance in his foreign financial account for each of the years 2004, 2005 and 2006 years as previously assessed by the government. The jury determined Mr. Zwerner was not “willful” as to the year 2007.

Essentially, the assessed FBAR penalties upheld by the jury aggregate \$2,241,809 on an offshore account that

had an apparent high balance of \$1,691,054 during the years at issue.

Many have been wondering what unique facts may have led the government to pursue what many believe to be unconstitutionally excessive multiple year, 50-percent FBAR penalties against Mr. Zwerner. Heightened tax enforcement efforts and increased penalties for noncompliance must be coupled with ongoing efforts to encourage taxpayers to voluntarily come into compliance. The perception of fairness (or unfairness) in the process can have a significant impact on the decisions of millions of other U.S. taxpayers presently contemplating whether to come into compliance with their filing and reporting requirements.

By previously trying to voluntarily come into compliance through the filing of amended returns and original FBARs, he was subjected to an IRS audit, then became ineligible for the 2011 OVDI and is now subjected to multiple-year, 50-percent FBAR penalties. It should be noted that taxpayers entering a criminal plea in matters involving FBAR violations typically receive a single-year 50-percent FBAR penalty based on the highest account value for the applicable tax years.

This is a significant win for the government in their efforts to encourage certain US persons having undisclosed interests in foreign financial accounts to come into compliance with the applicable filing and reporting requirements.

## The Excessive Fines Clause to the Rescue?

To many, pursuing multiple-year, maximum 50-percent penalties following submission of amended returns and delinquent FBARs appears punitive. The Excessive Fines Clause of the Eighth Amendment and relevant Supreme Court case law support a conclusion to the effect that a civil penalty or forfeiture is unconstitutional if the penalty or forfeiture is at least in part “punishment” and such punishment is grossly disproportionate to the conduct which the penalty is designed to punish. The touchstone of the constitutional inquiry under the Excessive Fines Clause is the principle of proportionality—the amount of the penalty must bear some relationship to the gravity of the offense that it is designed to punish.<sup>5</sup>

While post-trial arguments were pending on whether the *Zwerner* penalties violate the constitutional prohibition against excessive fines, the case settled with Mr Zwerner agreeing to 50-percent FBAR penalties assessed against him for 2004 and 2005 in the amounts of \$723,762 and \$745,209 respectfully, interest thereon of \$21,336.11

and \$20,947.52 respectively, plus statutory penalties that have accrued under 31 U.S.C. § 3717(e)(2) on the FBAR penalty assessments for 2004 and 2005 of \$128,016.64 and \$125,685.11 respectively.

U.S. taxpayers should carefully review the underlying factual scenario set forth in *C.R. Zwerner* before making any decision to pursue any form of voluntary disclosure regarding previously undisclosed interests in a foreign financial account. Many taxpayers are considering opting out of the OVDP—some might reconsider in light of the jury verdict in *Zwerner* for multiple FBAR penalties. Various taxpayers who have opted out of the OVDP have already received notices asserting multiple FBAR penalties for the years involved.

### *U.S.A. vs. Approximately \$12,000,000 in United States Currency*<sup>6</sup>

In a matter completely unrelated to *Zwerner*, on April 8, 2014, the U.S. government filed a Complaint seeking forfeiture of \$12,234,646.79 in *United States Currency* (hereafter, the “Defendant Currency”). Just when many thought the *Zwerner* matter set the civil high bar for what might possibly go wrong with respect to an undisclosed interest in a foreign financial account, along comes *U.S.A. vs. Approximately \$12,000,000 in United States Currency*<sup>7</sup> displaying yet another powerful tool in the U.S. governments international enforcement arsenal.

The Defendant Currency was previously held in two accounts at a bank located in Zurich, Switzerland. These Swiss bank accounts were nominally held in the names of entities but the Complaint alleges that the assets in the accounts were, in fact, beneficially owned by U.S. citizens (the “Taxpayer”).

The forfeiture Complaint alleges that from 2003 till sometime in 2013, the Taxpayer and the Taxpayer’s father concealed the existence of the Swiss bank accounts and the income earned in these accounts (the “Undeclared Accounts”) from the IRS and that, accordingly, the Defendant Currency is therefore subject to forfeiture pursuant to Code Sec. 981(a)(1)(A). In February 2014, the Defendant Currency was apparently voluntarily transferred from a Swiss bank to an IRS seized asset account, located in Manhattan, New York. Perhaps the repatriation of these funds into an IRS seized asset account part of some larger overall resolution of a matter involving the Taxpayer? Perhaps not ... time will tell.

The Complaint alleges that, Edgar Paltzer, an attorney in Switzerland who also operated as a financial intermediary, created various nominee entities under the laws of the

British Virgin Islands, Lichtenstein and Panama to assist the Taxpayer and the Taxpayer’s father in ensuring that the Undeclared Accounts at the Swiss banks remained hidden from U.S. authorities.

On or about April 16, 2013, Mr. Paltzer was indicted by a federal grand jury in the Southern District of New York for conspiring to defraud the United States and the IRS, and to commit offenses against the United States—violations of Code Secs. 7206(1) and 7201.

On or about August 28, 2013, Mr. Paltzer pled guilty to one count of conspiring with certain U.S. taxpayers and others to defraud the IRS of taxes due and owing and to evade file false tax returns. Many believe that Mr. Paltzer is cooperating with the U.S. authorities.

### **Applicable Forfeiture Statutes**

Code Sec. 981(a)(1)(A) subjects to forfeiture “[a]ny property real or personal involved in a transaction or attempted transaction in violation of ... section 1956, 1957 ... of this title, or any property traceable to such property.” Code Sec. 1956(a)(2) provides: “Whoever transports, transmits, or transfers, or attempts to transport, transmit, or transfer a monetary instrument or funds from a place in the United States to or through a place outside the United States or to a place in the United States from or through a place outside the United States- (A) with the intent to promote the carrying on of specified unlawful activity; [shall be guilty of money laundering].”

Code Sec. 1956(h) provides: “Any person who conspires to commit any offense defined in this section or section 1957 shall be subject to the same penalties as those prescribed for the offense the commission of which was the object of the conspiracy.”

### **Forfeiture of \$12,234,646.79 to the United States**

As alleged in the forfeiture Complaint,<sup>8</sup> years ago the Taxpayer transferred funds from inside the United States to Switzerland in order to defraud the IRS of taxes due and owing relating to the funds held in Taxpayer’s undeclared accounts in Switzerland. By reason of the foregoing, the U.S. government alleges that the Defendant Currency—\$12,234,646.79—is subject to forfeiture pursuant to Code Sec. 981(a)(1)(A).

An order approving forfeiture of the \$12,234,646.79 to the U.S. government would not preclude the ability of the government to separately and additionally pursue income taxes, penalties and interest under the Internal Revenue

Code<sup>9</sup> nor would it preclude assertion of FBAR penalties for the willful failure to comply with the reporting requirements of 31 U.S.C. §§ 5314 and 5321(a)(5) of up to 50 percent of the balance in the Undeclared Accounts, per year, for up to six tax years.

## The Way Forward

Time will tell whether the government begins a pattern of pursuing noncompliant U.S. taxpayers using mail and wire fraud related forfeiture statutes. The perception of fairness (or unfairness) in the process can have a significant impact on the decisions of millions of other U.S. taxpayers presently contemplating whether to come into compliance with their filing and reporting requirements.

If every tax evasion case is also deemed to include a mail/wire fraud violation, taxpayers moving funds on or offshore to accomplish the evasion might well be faced with allegations that the transfer was done “with the intent to promote the carrying on of a specified unlawful activity ...” subjecting the entire proceeds to forfeiture.<sup>10</sup>

The government will not and cannot pursue such actions against everyone. Many factors likely come into play in the exercise of government discretion on which matters to pursue, or not. Given the complexities of the Internal

Revenue Code, other relevant statutes and life in general, many of the indiscretions associated with an income tax return or FBAR are anything but willful or intentional and definitely not fraudulent in nature.

Worldwide respect for the integrity of the U.S. system of tax administration depends, at least in part, upon how the government continues to treat those who pursue some type of timely and truthful voluntary compliance with the filing and reporting requirements associated with their foreign financial accounts. A system of tax administration based in large part on voluntary compliance cannot ignore the potential impact associated with the manner in which those who voluntarily comply, even if in a somewhat awkward fashion (but before any contacts by the government), are treated.

Those who continue to have undeclared interests in foreign financial accounts and assets should immediately consult experienced, competent professionals. In each situation, the actual facts and circumstances must be carefully reviewed before anyone can determine the appropriate method of coming into compliance with the various filing and reporting requirements associated with offshore financial accounts.

Only one thing is certain, waiting to come into compliance is definitely not a viable option.

## ENDNOTES

<sup>1</sup> See [www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program](http://www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program).

<sup>2</sup> *J.B. Williams*, CA-4, 2012-2 USTC ¶150,475.

<sup>3</sup> *J. McBride*, DC-UT, 2012-2 USTC ¶150,666.

<sup>4</sup> See *C.R. Zwerner*, DC-FL, Case # 1:13-cv-22082-CMA (June 11, 2013).

<sup>5</sup> The standard the Court must use to decide this question is whether the penalties are “grossly disproportional to the gravity of a defendant’s offense.” *Bajakajian*, S Ct, 524 US 321, 333 (1998).

<sup>6</sup> See *U.S. v. Approximately \$12,000,000 in United States Currency*, DC-NY, 14-CV-2460 (Apr. 8, 2014).

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> Title 26, United States Code.

<sup>10</sup> But see Department of Justice, Tax Division Directive No. 145 “RESTRAINT, SEIZURE AND FORFEITURE POLICY IN CRIMINAL TAX AND TAX-RELATED INVESTIGATIONS AND PROSECUTIONS” (Jan. 30, 2014), Delegation of Authority, “8. ... I hereby delegate to the United States Attorney the authority to apply to the district court for an order to restrain and/or seize personal property for forfeiture arising from a criminal tax and/or tax-related investigation or prosecution when said personal property is restrained or seized pursuant to a provision of Title 18, except that: (a) No personal property shall be seized for forfeiture in a tax and/or tax-

related investigation if the personal property consists entirely of legal source income and the only criminal activity associated with the personal property is that unpaid taxes remain due and owing on the income.” and Ft. 4 “The forfeiture laws should not be used to seize and forfeit personal property such as wages, salaries, and compensation for services rendered that is lawfully earned and whose only relationship to criminal conduct is the unpaid tax due and owing on the income. Title 18 fraud statutes such as wire fraud and mail fraud cannot be used to convert a traditional Title 26 legal source income tax case into a fraud offense even if the IRS is deemed to be the victim of tax fraud.”

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