Playing Catch with a Hand-Grenade: How to Deal with an Unreported Foreign Bank Account in a Divorce

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When it comes to unreported foreign bank accounts, there is good news and bad news. The good news is that a previously unreported foreign bank account can dramatically increase the value of a divorcing couple's marital estate and may even make it easier to divide the assets and resolve the divorce. The bad news is that an unreported foreign bank account can result in large amounts of tax, tax penalties, and interest due to the IRS; can trigger large civil monetary penalties apart from taxes; and can even lead to criminal prosecution for this failure. Sometimes the risk that an unreported foreign account will explode into a huge problem is so high that nobody wants to admit having any connection to the account, but it nevertheless is something that must be addressed directly.

It is surprising how many people have an unreported foreign bank account, often without intending to hide assets from the IRS.[1] Maybe they inherited it from a relative, maybe they worked abroad in the past, or maybe they just like to have a bank

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[1] During various iterations of the IRS's Offshore Voluntary Disclosure Program ("OVDP"), which launched in 2009 and ended in September 2018, more than 56,000 United States taxpayers came forward to disclose their previously-unreported bank accounts, and paid a total of $11.1 billion in back taxes, interest and penalties. *See* IRS, *IRS to End Offshore Voluntary Disclosure Program* (Mar. 13, 2018), https://www.irs.gov/newsroom/irs-to-end-offshore-voluntary-disclosure-program-taxpayers-with-undisclosed-foreign-assets-urged-to-come-forward-now. It is unknown how many other taxpayers who own foreign bank accounts did not come forward during the OVDP or have not come forward since.

account while on vacation. Unreported foreign accounts often surface during a divorce as the spouses inventory the marital estate. The primary issue that must be considered is whether one or both of the spouses "willfully" failed to report the account and whether criminal prosecution or huge civil money penalties are likely. Divorce lawyers with high net-worth clients must be sensitive to the issues and risks surrounding foreign accounts and know when to bring in a tax specialist.

Part I of this article summarizes the reporting requirements for United States taxpayers who have an interest in one or more foreign bank accounts, and describes the issues regarding criminal and civil penalties that are presented by unreported foreign bank accounts. Part II reviews case law which suggests that courts are inclined to rule in favor of the government when it seeks to collect civil penalties assessed by the IRS for failure to report a foreign account. Part III examines two recent cases that addressed these civil penalties in the context of a divorce. Part IV explains how these civil penalties do not apply jointly and severally even if spouses filed joint income tax returns, but also how the same penalties may apply separately to each spouse. Part V reviews the alternatives that spouses with unreported foreign accounts should consider when deciding how to proceed. Finally, Part VI sets out a simple, straightforward framework for deciding what to do when an unreported foreign account surfaces during a divorce proceeding.

I. Reporting Requirements for Foreign Bank Accounts, and Criminal and Civil Penalties for Failure to Meet These Requirements

A. *Reporting Requirements*

Foreign bank and financial accounts must be reported to the Treasury Department in three different ways: on Schedule B of

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As an indication of how many United States persons have interests in foreign bank accounts, in 2019 more than 1.2 million Reports of Foreign Bank and Financial Accounts or "FBARs" were filed to report ownership of foreign bank accounts during 2018. *Ageny Information Collection Activities*, 85 Fed. Reg. 73129 (Nov. 16, 2020), https://www.federalregister.gov/documents/2020/11/16/2020-25216/agency-information-collection-activities-proposed-renewal-comment-request-renewal-without-change-of#footnote-9-p73130.

Form 1040, U.S. Individual Income Tax Return[2]; on Schedule 8938 to Form 1040; and on a separately filed Report of Foreign Bank and Financial Accounts or "FBAR." To make matters more complicated, each of these schedules and forms have their own filing thresholds and requirements.

First, every individual taxpayer who has a financial interest or signature authority over a foreign financial account, regardless of the amount in the account, must report this on Schedule B, Part III, Question 7a. of Form 1040.[3] The taxpayer must check a "Yes" or "No" box in response to the question: "At any time during [the tax year], did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?" Question 7a continues: "If 'Yes,' are you required to file Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements." This extra language is intended to alert taxpayers that they may have to file an FBAR.

Second, every taxpayer who has an interest in a foreign financial account with a value of more than $50,000 on the last day of the year, or more than $75,000 on any day during the year, must file an IRS Form 8938.[4] The Form 8938 is attached to the IRS Form 1040.

Third, any taxpayer who has a financial interest in, or signature authority over, foreign financial accounts whose aggregate value exceeded $10,000 at any time during the prior calendar year must file an FBAR. The FBAR is filed on FinCEN Form 114 and must be sent electronically to FinCEN, the Financial

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[2] U.S. Dep't of the Treasury, IRS Form 1040, *U.S. Individual Income Tax Return*, https://www.irs.gov/pub/irs-pdf/f1040.pdf.

[3] U.S. Dep't of the Treasury, IRS, Schedule B (Form 1040), https://www.irs.gov/pub/irs-pdf/f1040sb.pdf.

[4] U.S. Dep't of the Treasury, IRS Form 8938, *Statement of Specified Foreign Financial Assets*, https://www.irs.gov/pub/irs-pdf/f8938.pdf. Form 8938 "requires disclosure of a wide variety of foreign financial assets, including bank accounts, foreign stock or securities, ownership interests in a foreign entity, and any financial instrument or contract that has an issuer or counterparty that is not a U.S. person." Matthew D. Lee, *Uncovering Offshore Assets Using U.S. Tax Reporting Requirements as a Discovery Tool*, ABA FAM. ADVOC., Fall 2020, at 36, 37.

Crimes Enforcement Network.[5] This FBAR is completely separate from the IRS Form 1040 tax return. The FBAR must be filed by April 15 of the year following the year in which the taxpayer had the reportable interest. If the taxpayer does not file the FBAR on April 15, there is an automatic extension of time to file until October 15.

The result of all these separate reporting requirements is that a foreign bank or financial account, no matter what it is worth, must be reported on a tax return, and an account worth more than $50,000 must be reported in three different places each year. In addition, there are many other reporting requirements for foreign assets other than bank or financial accounts. For example, IRS Forms 5471[6] and 8865[7] must be filed to report a taxpayer's interest in or ownership of, respectively, certain foreign corporations or partnerships. IRS Form 3520[8] must be filed to report transactions with foreign trusts or the receipt of gifts from a foreign person. The universe of foreign asset reporting requirements and related penalties is large and complex, and a full discussion of all the potential foreign asset reporting penalties is beyond the scope of this article, which will focus solely on foreign bank accounts.

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[5] FinCEN is a bureau within the Department of the Treasury and is distinct from the IRS.

Until 2013 (and cases discussed in this article generally involve FBARs from before 2013), the FBAR was Form TD F 90-22.1, which was very similar to FinCEN Form 114, but was filed with the IRS on June 30 for the previous year. Prior to 2013, the question on Schedule B, Part III, Question 7a read, for example, "At any time during 2009, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See instructions on back for exceptions and filing requirements for Form TD F 90-22.1."

[6] U.S. Dep't of the Treasury, IRS Form 5471, *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*, https://www.irs.gov/pub/irs-pdf/f5471.pdf.

[7] U.S. Dep't of the Treasury, IRS Form 8865, *Return of U.S. Persons with Respect to Certain Foreign Partnerships*, https://www.irs.gov/pub/irs-pdf/f8865.pdf.

[8] U.S. Dep't of the Treasury, IRS Form 3520, *Annual Return To Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*, https://www.irs.gov/pub/irs-pdf/f3520.pdf.

B. *Penalties for Failure to Report Foreign Bank Accounts*

Criminal and/or civil penalties may be imposed for failure to report foreign bank accounts. Criminal penalties and the most significant civil penalties apply only if a taxpayer "willfully" failed to report a foreign account. Thus, evaluating whether the taxpayers acted willfully is one of the most important steps in determining how to handle an unreported foreign account. To make matters confusing, courts have interpreted the term "willfully" to mean different things in the criminal and civil penalty contexts. In criminal cases the government must prove willfulness by demonstrating beyond a reasonable doubt either that the taxpayer actually knew the account had to be reported but failed to do so, or at least that the taxpayer was "willfully blind," i.e. that he made "a conscious effort to avoid learning about reporting requirements."[9] In the civil context, courts have expanded the concept of willfulness to include reckless behavior as well.[10] While this article describes potential criminal penalties for failure to report a foreign bank account, we concentrate on case law regarding imposition of civil penalties.

1. *Criminal Penalties for Failure to Report a Foreign Bank Account*

A person who willfully fails to file an FBAR may be imprisoned for up to five years.[11] If a person fails to file an FBAR while violating another U.S. law, or as a pattern of any illegal activity involving more than $100,000 in a twelve-month period, the penalty is increased to not more than ten years imprisonment.[12] In addition to incarceration, civil penalties for willful failure to file an FBAR, discussed below, may be imposed as well.[13] Criminal failure to file an FBAR may also be charged as, or along with, various tax offenses, including:

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9 United States v. Sturman, 951 F.2d 1466, 1476-77 (6th Cir. 1991).

10 *See* Safeco Ins. Co. of America v. Burr, 551 U.S. 47, 57 (2007) (in the civil context, willfulness includes recklessness).

11 31 U.S.C. § 5322(a) (2001).

12 31 U.S.C. § 5322(b) (2001).

13 31 U.S.C. § 5321(d) (2004).

- Tax evasion, if tax is not paid on earnings from a foreign account, a felony subject to up to five years' imprisonment and/or $100,000 fine.[14]
- Filing a false tax return, a felony subject to up to three years' imprisonment and/or a fine of up to $100,000.[15]
- Corruptly impeding the administration of the IRS, a felony subject to up to three years' imprisonment and/or a fine of up to $5,000.[16]
- Conspiracy to commit an offense against or to defraud the United States, a felony subject to up to five years imprisonment.[17]

The U.S. Sentencing Guidelines determine whether a taxpayer convicted for failure to file an FBAR will be imprisoned. The Sentencing Guidelines indicate a range of sentences based on the size of the unreported foreign account. The likelihood of imprisonment increases dramatically as the amount in the unreported account increases. In general, a $500,000 unreported foreign account can trigger a prison sentence of 27 to 33 months, whereas an $1 million unreported foreign account can trigger a prison sentence of 33 to 41 months.[18] Of course, there are many

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[14] I.R.C. § 7201 (1982).

[15] I.R.C. § 7206(1) (1982) "Declaration under penalties of perjury" A defendant is guilty if he "[w]illfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter."; *See* United States v. Quiel, 595 Fed. Appx. 692, 694 (9th Cir. 2014) (affirming convictions for willfully filing false tax returns under I.R.C. § 7206(1) and willfully failing to file FBARs under 31 U.S.C. § 5322).

[16] I.R.C. § 7212(a) (1954): A defendant is guilty if she "corruptly . . . obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title."; *See* United States v. Little, 828 Fed. Appx. 34, 36 (2d Cir. 2020) (affirming conviction under § 7212(a), conspiracy to defraud the U.S., and failure to file tax returns and FBARs after defendant amassed offshore assets of the deceased taxpayer, and disbursed assets purportedly as gifts to the surviving spouse and family members).

[17] 18 U.S.C. § 371 (1994); *See Little*, Fed. Appx. at 36.

[18] *See* United States Sentencing Guidelines § 2S1.3; 2B1.1; Sentencing Table; *See also* United States v. Simon, No. 3:10–CR–00056(01)RM, 2011 WL 924264 at *9 (N.D. Ind. Mar. 14, 2011) (applying U.S. Sentencing Guideline § 2S1.3 to criminal failure to report foreign bank accounts).

facts and arguments that can reduce these sentencing ranges in certain circumstances.

The IRS and DOJ very actively pursue criminal cases involving unreported foreign bank accounts. The IRS and DOJ have prosecuted more than 120 criminal cases involving unreported foreign bank accounts. On October 15, 2020, the IRS and DOJ announced two of the largest criminal tax investigations ever, both involving unreported foreign accounts. One was against a private equity billionaire who admitted that he evaded more than $200 million of income by using secret foreign accounts in the Caribbean and Switzerland.[19] The other was against the owner of a software company who was indicted and charged with hiding nearly $2 billion of income from the IRS from 2000 through 2018 by using secret offshore accounts.[20] This does not mean that the IRS prosecutes only large dollar accounts. Several prosecutions have involved accounts of less than $1 million and one prosecu-

[19] This investigation ended with an unusual non-prosecution agreement, but the billionaire still admitted to committing crimes including failure to report his ownership of the secret foreign accounts, and his fifteen-year involvement in an illegal scheme to conceal income and evade taxes by using an offshore trust structure that he secretly controlled. *See* Exhibit A to Robert F. Smith Non-Prosecution Agreement, Statement of Facts (signed Oct. 9, 2020), https://www.justice.gov/opa/press-release/file/1327911/download. For the press release see U.S. Dep't of Justice, *Private Equity CEO Enters into Non-prosecution Agreement on International Tax Fraud Scheme and Agrees to Pay $139 Million, to Abandon $182 Million in Charitable Contribution Deductions, and to Cooperate with Government Investigations* (Oct. 15, 2020), https://www.justice.gov/opa/pr/private-equity-ceo-enters-non-prosecution-agreement-international-tax-fraud-scheme-and-agrees.

[20] United States v. Brockman, Case No. 3:20-cr-00371 (N.D. Ca. Oct. 1, 2020). The 39-count indictment charges criminal failure to file FBARs, conspiracy to defraud the United States by committing tax evasion, and substantive counts of tax evasion; and wire fraud, money laundering, and other offenses stemming from a scheme to defraud investors in debt securities issued by the defendant's company. The indictment is available at https://www.justice.gov/opa/press-release/file/1327921/download. For the press release see U.S. Dep't of Justice, *CEO of Multibillion-dollar Software Company Indicted for Decades-long Tax Evasion and Wire Fraud Schemes* (Oct. 15, 2020), https://www.justice.gov/opa/pr/ceo-multibillion-dollar-software-company-indicted-decades-long-tax-evasion-and-wire-fraud.

tion involved an unreported foreign account worth only $152,000.[21]

2. *Civil Penalties for Failure to Report a Foreign Bank Account*

The civil FBAR penalty statute provides two very distinct penalties: the non-willful penalty and the willful penalty. The *baseline* penalty, under subsection (B)(i) of the statute, applies to a non-willful violation of the FBAR filing requirement (the "non-willful civil FBAR penalty").[22] The non-willful civil FBAR penalty is capped at $10,000 per year. The IRS can assess a $10,000 non-willful civil FBAR penalty for each of multiple years.[23]

A taxpayer who can prove that a non-willful "violation was due to reasonable cause" may avoid penalties altogether.[24] But reasonable cause for failure to report a foreign bank account can be difficult to establish. The IRS often takes the position that reasonable cause relief will be granted only if the taxpayer can prove that she told her accountant about the foreign account and the accountant mistakenly failed to report the account or gave incorrect advice that the account need not be reported.[25]

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[21] *See, e.g.,* Remy Farag, *HSBC Client Prosecuted After Quiet Disclosure*, 22 J. Int'l Tax'n 8 (Aug. 2011)(describing the prosecution of a defendant who had a high balance of $152,566 in a single undeclared foreign bank account).

[22] 31 U.S.C. § 5321(a)(5)(B)(i).

[23] *See, e.g.*, Moore v. United States, No. C13–2063RAJ, 2015 WL 4508688 at *1 (W.D. Wa. July 25, 2015) ("the IRS's decision to assess Mr. Moore FBAR penalties of $10,000 for each year from 2005 through 2008 was not arbitrary, not capricious, and not an abuse of its discretion"); *See also* Internal Revenue Serv., Internal Revenue Manual ("IRM") § 4.26.16.6.4.1 (Nov. 6, 2015) ("Penalty for Nonwillful Violations – Calculation") ("in most cases, examiners will recommend one penalty per open year," although "[f]or multiple years with nonwillful violations, examiners may determine that asserting nonwillful penalties for each year is not warranted").

[24] 31 U.S.C. § 5321(a)(5)(B)(ii).

[25] *See* Paul Marcotte, Jr., *Pain Relief from Undisclosed Offshore Holdings: IRS International Penalty Procedure and Strategy*, 25 J. Int'l Tax'n 26, 32 (Mar. 2014) (emphasis added):

> The Service routinely scrutinizes claims for penalty relief related to delinquent international information returns when reliance on a tax advisor is asserted as the ground for reasonable cause. *In particular,*

The baseline $10,000 non-willful civil FBAR penalty is increased for willful FBAR violations. The willful penalty provisions (the "willful civil FBAR penalty"), read:

> (C) Willful violations.—In the case of any person willfully violating, or willfully causing any violation of, any provision of [a section of the Bank Secrecy Act of 1970[26] under which the Secretary of the Treasury requires a resident or citizen of the United States to file certain reports of foreign transactions ("the BSA provision")[27]]—
>
> (i) the maximum penalty under subparagraph (B)(i) shall be increased to the greater of—
>
> (I) $100,000, or
>
> (II) 50 percent of the amount determined under subparagraph (D).
>
> (D) Amount.—The amount determined under this subparagraph is—
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> . . . .
>
> (ii) in the case of a violation involving a failure to report the existence of an account or any identifying information required to be provided with respect to an account, the balance in the account at the time of the violation.[28]

As the statute indicates, a willful failure to report a foreign bank account can bring crushing civil penalties of as much as 50% of the value of the unreported foreign account. The statute of limitations is six years so, theoretically, the IRS could impose six 50% penalties equal to a total of 300% of the value of the

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> *the Service demands proof that the advisor knew of the undisclosed account or activity for which a return was not filed timely.*

See also Khrista McCarden, *Offshore Tax Enforcement and Divorce*, 80 Ohio St. L.J. 521, 537 n.56 (2019) ("If a taxpayer can prove reasonable cause for failing to file an FBAR, e.g., the taxpayer told a tax preparer who neglected to file the FBAR about the foreign account(s), no penalty will be imposed.").

Compare with Jarnagin v. United States, 134 Fed. Cl. 368, 378-79 (Fed. Ct. Cl. 2017) (finding no reasonable cause where taxpayers "neither requested nor received any advice one way or the other from their accountants regarding whether they were required to file FBARs"); United States v. Schwarzbaum, Case No. 18-cv-81147-BLOOM/Reinhart, 2020 WL 1316232 at **9-10 (S.D. Fla. 2020), *appeal filed*, 11th Cir. Case No. 20-13989 (Oct. 23, 2020) (discussing reasonable cause in connection with non-willfulness rather than penalty relief, but holding that a taxpayer's reliance on an accountant's incorrect advice that only accounts with connection to the United States need be reported constituted reasonable cause).

26 Pub. L. No. 91-508, 84 Stat. 1114 and amendments (31 U.S.C. §§ 5311-5314, 5316-5330, 5331, 5332; 12 U.S.C. §§ 1829, 1951-1959).

27 31 U.S.C. § 5314 (1982).

28 31 U.S.C. §§ 5321(a)(5)(C) & (D).

account. In practice, the IRS has not imposed quite such draconian penalties. However, the IRS has in many instances imposed penalties, taxes, and interest that have exceeded the value of an unreported account, and in one case imposed the 50% penalty for three years.[29]

II. Case Law Regarding Civil FBAR Penalties

The great majority of federal district courts that have ruled on the government's suits to collect civil FBAR penalties have involved willful civil FBAR penalties,[30] and the courts have usually ruled in the government's favor, holding that the taxpayers did willfully fail to report a foreign account, either after a hearing on the government's motion for summary judgment or after a bench trial. Most of these decisions have focused on how the taxpayer answered Schedule B, Part III, Question 7a. of Form 1040, about whether he or she had an interest in a foreign bank account, and have reasoned that a taxpayer who answered "No" to this question acted willfully – or recklessly, which equates to willfulness in the civil penalty context – requiring imposition of the huge 50% willful FBAR penalty. Some courts have essentially relied solely on the fact that a taxpayer signed tax returns with this question answered falsely, while other courts have required additional evidence of the taxpayer's willfulness or recklessness.

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[29] Michael Saltzman, IRS Practice and Procedure ¶ 12.04[3](b) at *7 & n.475.1 (2020) (citing IRM § 4.26.16.6.5.3 (Nov. 6, 2015)):

> The Service takes the position that the 50 percent willful penalty can apply to each year for which the statute of limitations is open. In a well-publicized case, the Service asserted the maximum penalty for three years. The IRM says that, "in most cases, the total penalty amount for all years under examination will be limited to 50 percent of the highest aggregate balance of all unreported foreign financial accounts during the years under examination." The key qualification to this internal guidance is that it is the general rule, and examiners may propose a willful penalty higher or lower than these amounts.

[30] It is within the IRS or the government's discretion whether to assess the willful civil FBAR penalty or the non-willful civil FBAR penalty, and the great majority of reported cases involve the willful penalty. For one case where the non-willful penalty was imposed, see *United States v. Hidy,* 471 F. Supp. 3d 927 (D. Neb. 2020) (rejecting the taxpayers' argument that the reasonable cause exception applied).

A. United States v. Williams *and* United States v. McBride

Two seminal cases from 2012, *United States v. Williams*,[31] and *United States v. McBride*,[32] both effectively held that taxpayers who have an interest in a foreign bank account and who checked the "No" box in response to question 7a. on Schedule B of their tax return have acted recklessly, and that this is sufficient to trigger the willful civil FBAR penalty. The courts reasoned that, by signing a tax return under penalty of perjury, a taxpayer has constructive knowledge of Question 7a. on Schedule B, Part III, requiring the taxpayer to check the box "Yes" or "No" concerning whether he or she owns a foreign account, and the taxpayer therefore has constructive knowledge of that question's follow up reference to the need to file an FBAR. According to the courts, a taxpayer therefore has constructive knowledge of her duty to file an FBAR, and is reckless and/or "willfully blind"– and hence "willful" as that term has been defined in context of civil tax penalties[33] – if she fails to file a timely or accurate FBAR. In both *Williams* and *McBride*, the courts affirmed the 50% civil penalty for willfully failing to file an FBAR.

Williams was the first federal appellate case to address the willful civil FBAR penalty. Setting out a theory of constructive knowledge combined with "willful blindness," the court wrote:

> A taxpayer who signs a tax return will not be heard to claim innocence for not having actually read the return, as he or she is charged with constructive knowledge of its contents. . . .
>
> Nothing in the record indicates that Williams ever consulted [the FBAR form] or its instructions. In fact, Williams testified that he did not read line 7a and "never paid any attention to any of the written words" on his federal tax return.
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> . . . . Thus, Williams made a "conscious effort to avoid learning about reporting requirements," and his false answers on both the tax organizer [where his accountant asked if he had a foreign bank account] and his federal tax return evidence conduct that was "meant to con-

31 489 Fed. Appx. 655 (4th Cir. 2012).

32 908 F. Supp. 2d 1186 (D. Utah 2012).

33 Safeco Ins. Co. of Am. v. Burr, 551 U.S. 47, 57 (2007) (in cases "where willfulness is a statutory condition of civil liability, we have generally taken it to cover not only knowing violations of a standard, but reckless ones as well").

> ceal or mislead sources of income or other financial information." . . . This conduct constitutes willful blindness to the FBAR requirement.[34]

The court concluded that "at a minimum, Williams's undisputed actions establish reckless conduct, which satisfies the proof requirement" for imposition of willful civil FBAR penalties.[35]

The court's reliance on "constructive knowledge," recklessness, and "willful blindness" was unnecessary, however, because the facts demonstrated that Williams was *knowingly* willful. Most significant was Williams' admission in open court as part of his guilty plea that: "*I knew that I had the obligation to report to the IRS and/or the Department of the Treasury the existence of the Swiss accounts*, *but I chose not to* in order to assist in hiding my true income from the IRS and evade taxes."[36] This irrefutable *direct* evidence of Williams' intentional choice not to file FBARs when he knew he was required to do so established his willfulness, and the court did not need to come up with its theories of indirect proof.

The district court decision in *United States v. McBride* held that McBride was liable for willful civil FBAR penalties for 2000 and 2001. The court titled a section of its opinion unequivocally: "Constructive Knowledge of the Reporting Requirement Is Imputed to Taxpayers Who Sign Their Federal Tax Returns."[37] It concluded that, because McBride signed his tax returns for 2000 and 2001, he was charged with having reviewed the returns; having understood that they asked if he held a foreign bank account during the tax year and that they referenced the FBAR form; and

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34 *Id*. at 659. The court imported from criminal cases the concepts of a "conscious effort to avoid learning about reporting requirements," *id.* at 658 (quoting *Sturman*, 951 F.2d at 1476, a criminal FBAR case), and "willful blindness," which may be inferred where "a defendant was subjectively aware of a high probability of the existence of a tax liability, and purposefully avoided learning the facts that point to such liability," *id*. (quoting *United States v. Poole*, 640 F.3d 114, 122 (4th Cir. 2011), a criminal tax case).

35 *Id*. at 660. *See Safeco Ins. Co.*, 551 U.S. at 57 ("where willfulness is a statutory condition of civil liability, we have generally taken it to cover not only knowing violations of a standard, but reckless ones as well").

36 *Id*. at 659 (emphasis added); Additional evidence of Williams' willfulness was that he opened two Swiss bank accounts in the names of British corporations, and he answered "no" to the question in his accountant's annual tax organizer about whether he had a foreign account. *Id*. at 656.

37 908 F. Supp. 2d at 1207.

therefore having had constructive knowledge of the requirement to file FBARs.[38]

The court went even further, however, relying on *Lefcourt v. United States*[39]—an inapplicable case which did not involve a civil FBAR penalty and never mentioned either "constructive knowledge" or "willful blindness"—to hold it was *irrelevant* that McBride *subjectively believed* he was not required to file FBARs.[40] The court thereby imposed strict liability for a willful civil FBAR penalty, and essentially left no room for application of the non-willful penalty:

> "Once it is determined, as it was here, that the failure to disclose . . . information was done purposefully, rather than inadvertently, it is irrelevant that the filer may have believed he was legally justified in withholding such information. The only question that remains is whether the law required its disclosure." . . . *The government does not dispute that McBride's failure to comply with FBAR was the result of his belief that he did not have a reportable financial interest in the foreign accounts*. However, because it is irrelevant that McBride "may have believed he was legally justified in withholding such information, [t]he only question that remains is whether the law required its disclosure." . . . Here, the FBAR requirements did require that McBride disclose his interests in the foreign accounts during both the 2000 and

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[38] *Id*. at 1207-08. The court acknowledged cases holding that a taxpayer's signature on a tax return does not by itself prove that the taxpayer knew what was in the return, but used tortured reasoning to distinguish "knowledge of what entries and submissions are made by the taxpayer or the taxpayer's preparer" on the tax return form, from "knowledge of what instructions are contained within the form [which] is directly inferable from the contents of the form itself, even if it were a blank." *Id*. at 1207. This distinction is meaningless, however, because checking the "Yes" or "No" box about whether a taxpayer had an interest in a foreign account *is* an entry on the form that must be made by the taxpayer or the taxpayer's preparer.

[39] 125 F.3d 79 (2d Cir. 1997).

[40] The court also held that even if an accountant "failed to properly advise McBride to report his interests in the foreign accounts, this would not excuse McBride. The taxpayer, not the preparer, has the ultimate responsibility to file his or her return and pay the tax due." *Id*. at 1213. This contradicts the statutory reasonable cause exception under 31 U.S.C. § 5321(a)(5)(B)(ii), discussed above, where a taxpayer's reliance on a tax professional's advice that she need not file FBARs may constitute reasonable cause to avoid any penalties at all.

> the 2001 tax years. As a result, McBride's failure to do so was willful.[41]

Williams and *Lefcourt*, an irrelevant case,[42] were the *only* authorities on which the *McBride* court relied for its extraordinary conclusion that a taxpayer's belief that he is not required to file an FBAR is irrelevant to the taxpayer's willfulness. As in *Williams*, however, the facts of *McBride* amply supported a finding that McBride was willful without any need for the court to address "constructive knowledge" or a purposeful act as opposed to inadvertence. "McBride *was aware* that he was engaged in a plan to avoid income taxes by hiding his interest in assets in over-

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[41] *Id*. at 1213-15 (emphasis added; brackets in original)(quoting *Lefcourt*, 125 F.3d at 83, and citing *Williams*).

[42] *Lefcourt* had no application to the civil willful FBAR penalty. It addressed a completely different penalty, under I.R.C. § 6721(e)(1990) for "intentional disregard" of the requirement to file IRS Form 8300, "Report of Cash Payments Over $10,000 Received in a Trade or Business." The case involved a law firm's *intentional* refusal to reveal on Form 8300 the identity of a client who faced criminal charges, citing the client's constitutional protections and the lawyers' professional responsibility. *Id*. at 81. It was "uncontested that *Lefcourt* was aware that Form 8300 asked for its client's identity and nonetheless *chose* to refuse to provide the name." *Id.* at 83 (emphases added). It was against this background that the court wrote its inflexible language distinguishing inadvertence from a voluntary act based on an unsupported belief that filing is not required. *McBride*'s asserted belief that he did not have to file FBARs was in no way comparable to an *awareness* that he was required to file FBARs and a *choice* not to do so.

In addition, because the *Lefcourt* decision mentioned neither constructive knowledge nor willful blindness, it was unwarranted for the *McBride* court to engraft *Lefcourt*'s strict line between a voluntary act (which in *Lefcourt* really meant a *knowing and intentional* act) and an inadvertent act onto the willful civil FBAR penalty. The IRS itself has recognized that: "The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, in itself, to establish that the FBAR violation was attributable to willful blindness," and this fact should be coupled with other facts "such as the efforts taken to conceal the existence of the accounts and the amounts involved" in order to conclude that an FBAR violation was due to willful blindness. IRM § 4.26.16.6.5.1(5)(Nov. 6, 2015).

Finally, the tax penalty that *Lefcourt* discussed, like the *non-willful* civil FBAR penalty, could be waived if the failure to file Form 8300 was due to reasonable cause. 125 F.3d. at 84-85. There is no such reasonable cause relief from a *willful* civil FBAR penalty, however, an additional reason why *Lefcourt*'s strict application of a penalty was inapplicable to the situation in *McBride*.

seas shell corporations."[43] He did not discuss foreign accounts he controlled with his personal accountant;[44] and, most importantly, he *knew* that the plan aimed to avoid disclosing foreign accounts, because he reasoned, "*if you disclose the accounts on the form, then you pay tax on them*."[45] On these facts, there was no reason for the court's reductive analysis of willfulness.

Both *Williams* and *McBride* are examples of the adage that bad facts make bad law because, in both cases, there was abundant evidence that the taxpayers actually knew they had to report their foreign accounts, so the concepts of constructive knowledge, willful blindness, and recklessness were irrelevant. The courts did not need to rely on these concepts to find the taxpayers liable for the willful civil FBAR penalty. The cases' analyses have been criticized as essentially abrogating the non-willful civil FBAR penalty.[46]

B. *The Fourth Circuit's Recent Possible Retreat From* Williams

In a very recent case, *United States v. Horowitz*,[47] the Fourth Circuit affirmed the district court ruling that the taxpayer acted willfully and was subject to the 50% civil FBAR penalty, but may have retreated somewhat from *Williams*, since it did not rely on a "constructive knowledge" theory of liability. The court adhered to *William*'s holding that willfulness in the civil FBAR context includes recklessness.[48] It then held, significantly, that the taxpayers' repeated failure to review their tax returns (on which the box was checked "No" as to whether they owned foreign bank accounts) with enough care "at least to discover their misrepresentation of foreign bank accounts," was only "*an aspect* of their recklessness."[49]

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43 *Id*. at 1205 (emphasis added). When McBride first learned of the plan, his reaction was: "This is tax evasion." *Id*. at 1190, 1210.

44 *Id*. at 1189, 1199.

45 *Id*. at 1205 (emphasis added).

46 *See. e.g.* Kyle Niewoehner, Comment, *Feigning Willfulness: How* Williams *and* McBride *Extend the Foreign Bank Accounts Disclosure Willfulness Requirement and Why They Should Not Be Followed*, 68 TAX LAW. 251, 257 (2014).

47 978 F.3d 80 (4th Cir. 2020).

48 *Id.* at 88.

49 *Id*. at 90. (emphasis added).

The court relied on other indicia of recklessness to uphold the penalty: The account was a numbered account with a "hold mail" instruction (which the bank itself admitted was a means to assist U.S. customers to conceal their assets); so, although the husband claimed not to have requested these aspects of the account, "he surely became aware of their effect as he thereafter communicated with the bank and received no mail from it. This conduct further evinces more than mere negligence."[50] The court found that the taxpayers could not have overlooked the account, since it was the family's "nest-egg retirement account," and they traveled to Switzerland twice "specifically to look after it."[51] Affirming the district court's decision that the taxpayers were liable for willful civil FBAR penalties, the court concluded:

> *Taking all of these circumstances together*, the record indisputably establishes not only that the [taxpayers] "clearly ought to have known" that they were failing to satisfy their obligation to disclose their Swiss accounts, but also that they were in a "position to find out for certain very easily." . . . Despite numerous red flags, they neither made a simple inquiry to their accountant nor gave even the minimal effort necessary to render meaningful their sworn declaration that their tax returns were accurate.[52]

The Court of Appeals did not mention "constructive knowledge" (and so did not outright repudiate *Williams*' reliance on that theory) and relied on cumulative circumstances in addition to the taxpayers' signatures on their tax returns in determining that the taxpayers were willful. Accordingly, the decision could undermine the government's arguments that simply answering "no" to the question about foreign bank accounts on an income tax return is sufficient, in itself, to create "constructive knowledge" of the FBAR requirement and, therefore, to support imposition of a willful civil FBAR penalty.

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[50] *Id.*

[51] *Id.* The taxpayers knew that their nearly $2 million in a Swiss bank account was earning interest income, knew that domestic interest income was taxable, and so "could hardly conclude reasonably that the interest income from their Swiss accounts was not subject to taxes." *Id.*

[52] *Id.* (emphasis added).

C. *Some Recent Cases Have Closely Followed* Williams *and* McBride

In 2018, the Court of Federal Claims in *Kimble v. United States*[53] rested its decision that the taxpayer was liable for the 50% willful civil FBAR penalty on two simple stipulations: "Plaintiff did not review her individual income tax returns for accuracy"; and "Plaintiff answered 'No' to Question 7(a) on her 2007 income tax return, falsely representing under penalty of perjury, that she had no foreign bank accounts."[54] The court held that these two facts alone sufficed to "evidence conduct by Plaintiff . . . that exhibited a 'reckless disregard' of the legal duty under federal tax law to report foreign bank accounts to the IRS by filing a FBAR," and so granted summary judgment to the government.[55]

In 2019, in *United States v. Rum*,[56] a court in the Middle District of Florida granted the government's motion for summary judgment to collect on the IRS's assessment of a 50% willful civil FBAR penalty, citing both *Williams* and *McBride*, and holding:

> A taxpayer's failure to review their tax returns for accuracy despite repeatedly signing them, along with "falsely representing under penalty of perjury" that they do not have a foreign bank account (by answering "no" to question 7(a) on Line 7a of Schedule B of a 1040 tax return) *in and of itself* supports a finding of "reckless disregard" to report under the FBAR.[57]

The court discussed additional evidence supporting that Rum was willful but emphasized that this evidence was "*not* necessary to establish willfulness."[58]

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[53] 141 Fed. Cl. 373 (Ct. Fed. Cl. 2018). The taxpayer paid the civil willful FBAR penalty assessed by the IRS and then filed suit in the Court of Federal Claims seeking a refund.

[54] *Id*. at 385.

[55] *Id*. at 386.

[56] Case No. 8:17-cv-826-T-35AEP, 2019 WL 3943250 (M.D. Fla. Aug. 2, 2019).

[57] *Id*. at *8. (emphasis in original).

[58] *Id*. (emphasis in original).

D. *Other Courts Have Directly Rejected* Williams*' and* McBride*'s Constructive Knowledge Theory*

Two district courts have outright rejected *Williams*' and *McBride*'s reasoning that Form 1040, Schedule B, Question 7a provides "constructive knowledge" of the FBAR filing requirement. These courts, however, agreed with other decisions that a taxpayer may be reckless and therefore willful in avoiding learning about the FBARs requirements—and held that recklessness may *include* not reading tax returns, at least when the taxpayer is a sophisticated businessman.

In a case from the Southern District of Texas in 2018, *United States v. Flume*,[59] the government sought summary judgment for the 50% willful civil FBAR penalty. Because Flume admitted that he failed to report his UBS account in tax years 2007 and 2008, the only question, was "whether a reasonable factfinder could conclude that this failure was not willful."[60] The government relied on *Williams* and *McBride* to argue that Flume was willful simply because, by signing his 2007 and 2008 tax returns which contained references to the FBAR requirements, he constructively knew about those requirements. The court held, however, that those cases had the unwarranted result of "effectively making *every* taxpayer who fails to follow [a tax return's direction to review the FBAR] requirements a 'willful' violator."[61] The court found the constructive-knowledge theory "unpersuasive" because it "ignores the distinction Congress drew between willful and non-willful violations."[62] It concluded: "If every taxpayer, merely by signing a tax return, is presumed to know of the need to file an FBAR, 'it is difficult to conceive of how a violation could be nonwillful.' "[63]

As a result, the court could not presume on summary judgment that Flume knew about the FBAR requirements merely because he signed his 2007 and 2008 tax returns under penalties of perjury.[64] In addition, the court held that *Williams*' and *McBride*'s constructive-knowledge theory was not based on sound

59 No. 5:16-CV-73, 2018 WL 4378161 (S.D. Tex. Aug. 22, 2018).

60 *Id*. at *1.

61 *Id*. (emphases added)

62 *Id*. at *7.

63 *Id.* (citing Niewoehner, *supra* note 46).

64 *Id*.

policy, because "to have 'constructive knowledge' of something 'means you don't have [knowledge] of it but the law will pretend you do' for policy reasons."[65] But no policy requires use of "constructive knowledge" to prevent a taxpayer from escaping liability "by simply claiming he did not read what he was signing."[66] Instead, because reckless disregard of the FBAR filing requirement may constitute willfulness, there was no "policy need to treat constructive knowledge as a substitute for actual knowledge."[67]

The court then refused to grant summary judgment on the question of recklessness because Flume testified that he relied on his tax preparer's competence so "it was arguably not reckless for him to not 'bother' reading the FBAR instructions"; and since Schedule B's direction to see instructions for FBAR filing requirements mentions "exceptions" to those requirements, "Flume might understandably have reasoned that he did not have to file an FBAR because his preparer had determined that one of those exceptions applied."[68]

In a later 2019 decision on the merits,[69] however, the court found that Flume was indeed willful, because, among other reasons, Flume's offshore financial structure demonstrated "a sophisticated tax-evasion scheme"[70] and, because Flume disclosed a Mexican bank account on Schedule B of his tax returns, "he was aware of the foreign-account reporting requirement and made a conscious choice not to disclose his Swiss account."[71] In

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65 *Id.* (brackets in original).

66 *Id.* (quoting the government's argument).

67 *Id.*

68 *Id.* at *9.

69 United States v. Flume, 390 F. Supp. 3d 847 (S.D. Tex. 2019).

70 *Id.* at 855 (citing United States v. Bohanec, 263 F. Supp. 3d 881, 889–90 (C.D. Cal. 2016) (taking into account the defendants' business experience and financial sophistication in determining that willful civil FBAR penalties were proper).

71 *Id.* (citing United States v. Kelley-Hunter, 281 F. Supp. 3d 121, 123-24 (D.D.C. 2017) (finding that the defendant demonstrated her prior knowledge of the FBAR requirements by reporting foreign accounts other than the one in connection with which the IRS sought FBAR penalties).

In addition, *Flume* knew about the IRS's investigation into UBS by mid-2008, but did not file delinquent FBARs until after UBS agreed to turn over to the United States its U.S. clients' records, which strongly suggested that Flume knew he was breaking the law but thought he could get away with it until it

addition, while the court might have been "more lenient with an unsophisticated defendant who genuinely could not understand the language of his tax return," Flume was "a sophisticated businessman," who therefore "acted with extreme recklessness by failing to review his tax returns before signing them."[72]

> Schedule B's question about foreign bank accounts is simple and straightforward and requires no financial or legal training to understand" so "the most cursory review of his tax return would have alerted Flume to the foreign-account reporting requirement."[73]

The 2020 case of *United States v. Schwarzbaum*,[74] from the Southern District of Florida, is one of the few decisions rejecting the government's attempt to assert the 50% willful civil FBAR penalty, but only for one of the years involved in the case. The court first rejected the government's reliance on "the notion from case law that a taxpayer is charged with knowledge of the information on a tax return by virtue of signing it under penalties of perjury," finding fault with *Williams* and *McBride*:

> Imputing constructive knowledge of filing requirements to a taxpayer simply by virtue of having signed a tax return would render the distinction between a non-willful and willful violation in the FBAR context meaningless. Because all taxpayers are required to sign their tax returns, a violation of the FBAR filing requirements could never be non-willful. Yet, the statute provides for non-willful penalties.[75]

After a bench trial, the court held that Schwartzbaum was not liable for a willful civil FBAR penalty for 2006 based on a willful blindness analysis, because he believed from his accountant's incorrect advice that a foreign account should have some connection with the United States before he was required to re-

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became clear that U.S. authorities would learn of his account. *Id*. at 856-57 (citing *Kelley-Hunter*, 281 F. Supp. 3d at 123 (willful civil FBAR penalties were proper in part because the defendant immediately filed a late FBAR after "she received a letter from UBS . . . that the bank had disclosed the existence of her account to the IRS").

72 *Id*. at 857 (citing Bedrosian v. United States, 912 F.3d 144, 152 (3d Cir. 2018) (in the FBAR context, willfulness "often denotes . . . conduct marked by careless disregard" about a taxpayer's legal duties.).

73 *Id*. (citing *McBride*). The court's reliance on Schedule B's "straightforward" question would seem to be limited to a "sophisticated" taxpayer.

74 2020 WL 1316232.

75 *Id*. at *8.

port it.[76] But with respect to 2007 through 2009, Schwarzbaum *was* willfully blind and liable for the willful civil FBAR penalty because "at least for 2007, he reviewed the instructions for the FBAR form" so he could no longer rely on his accountant's prior advice.[77] The government has appealed the decision to the Eleventh Circuit.[78]

III. Two Recent Cases Addressing the Civil FBAR Penalty in the Context of a Divorce

As noted, unreported foreign bank accounts often surface in divorce cases and one spouse may argue that she or he relied on the other spouse, or that the circumstances of the divorce somehow justified the failure to properly report the foreign account. Courts have been skeptical of these arguments and tend to hold divorcing spouses to the same standard as any other taxpayer in determining whether they willfully – or recklessly – failed to report the account.

In *United States v. DeMauro*,[79] the court found that Annette DeMauro was willful in failing to file FBARs.[80] In 1993, Annette initiated a divorce proceeding against her husband, Joseph, on the grounds of adultery. The litigation spanned nine years, after which the court awarded Annette a $35 million cash judgment, which Joseph never paid, and three real estate properties.[81] Annette testified that, during the divorce, Joseph repeatedly harassed her, sent people to her home to threaten or intimidate her, attempted to set fire to her home, and once tried to run her off the road.[82] The divorce decree provided that Joseph would indemnify Annette for any income tax that might be owed. Annette testified at trial that her "understanding was that whatever I received from the – my divorce decree was mine and mine alone and that went for anything I received, and it was nontaxable."[83]

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76 *Id*. at *10.
77 *Id*. at ** 10-11.
78 11th Cir. Case No. 20-13989 (Oct. 23, 2020).
79 No. 17-cv-640-JL, 2020 WL 5757466 (D.N.H. Feb. 28, 2020).
80 *Id*.
81 *Id*.
82 *Id*.
83 *Id*.

In 2002, after her divorce from Joseph was finalized, Annette opened a numbered account at UBS in Switzerland. She formed a relationship with a client advisor at UBS with whom she met twice, and who allegedly faxed to her account opening documents that she signed and sent back but did not fill out. At times, Annette consulted with UBS employees about her account.[84]

Annette went most of her life never having filed tax returns. The first return she filed was in 2001, to report the gain from her sale of a piece of real estate that she received from the divorce. Unfortunately, the return, which was prepared by Annette's advisors, did not report her foreign bank account. Annette failed to file any other tax returns from 2002 to 2012. In 2012, she filed delinquent returns for 2005 through 2010. She conceded at trial that, after she filed the 2001 tax return, she did not seek professional advice about whether she should file a federal tax return, nor about whether income earned on her foreign account was taxable.

In 2006, Annette moved her funds from UBS to Zurcher Kantonalbank because her contact at UBS moved to the new bank. In 2009, she traveled to Switzerland to close her account because her client advisor "told her that the Swiss government was making Americans close their Swiss accounts."[85] She transferred her funds to accounts in the Czech Republic. She then transferred over $1.3 million from the Czech Republic to a domestic account, including a large sum after her ex-husband's death.[86]

In analyzing whether Annette was willful in failing to file an FBAR in 2008, the court noted that she took steps to conceal her foreign accounts, but "she credibly testified that she did so in an attempt to hide assets from her abusive ex-husband—an explanation that even the IRS investigator believed and found compelling—and because she trusted the many professionals around her to take care of the finer details of her finances."[87]

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84 *Id.* at **2-3.

85 *Id.*

86 *Id.* at *5.

87 *Id.* at **1, 11.

Based on these findings, the court held that Annette did not knowingly fail to file FBARs.[88] It concluded, however, that Annette was reckless because her explanation for failing to seek advice about her tax and reporting obligations "strains credulity"[89] Annette testified that she did not ask any professional for advice about the tax or reporting requirements with respect to her foreign accounts "because she believed, based on her own interpretation of her divorce decree, that she owed no taxes on anything received from her divorce, including interest she concedes she knew was accruing." This explanation was "neither objectively reasonable nor subjectively credible," and Joseph's agreement to indemnify Annette did not translate into Annette not owing taxes.[90]

Annette was also willfully blind because she failed to seek advice from tax professionals or attorneys about whether she should file tax returns despite (1) her past practice of relying on professionals to handle her affairs, (2) her admission that she knew her foreign accounts were accruing interest, (3) her 2001 payment of taxes on a sale of property she acquired through her divorce decree, (4) her 2001 payment of taxes on interest earned from her domestic savings accounts, and (5) her representation to UBS that she had sought unspecified tax advice relating to her account.[91] Even if she was not willfully blind, the court held, again, that Annette acted recklessly.[92]

In *United States v. Cohen*,[93] another case involving a divorce, the court refused to grant summary judgment, imposing a 50% willful FBAR penalty as a matter of law against Fariba Cohen. Fariba was a self-employed licensed insurance agent, who filed for divorce from her husband, Saeed Cohen, in 2008.[94]

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88 *Id*. at **11-12.

89 *Id*. at *12.

90 *Id*.

91 *Id*.

92 *Id*. Notably, the court's conclusions about willfulness in the FBAR context were almost wholly based on its findings about Annette's willful blindness to her *tax-filing* obligations, not on evidence specifically about what she knew or should have known about FBARs.

93 No. CV 17-1652-MWF (JCx), 2019 WL 8231039 (C.D. Cal. Dec. 16, 2008).

94 *Id*. at *4.

With the assistance of their attorney, the couple had opened a foreign bank account while they were married over which they both had joint signature authority, and established offshore entities owned 50% by Saeed and Fariba, which in turn held foreign bank accounts.[95] Fariba's signature appeared on documents establishing these foreign bank accounts and she and Saeed met with representatives of at least two of the foreign banks.[96] Fariba asserted, however, that Saeed signed her name on official bank documents.[97] It was also undisputed that Fariba met with the attorney numerous times, although it is not clear whether she ever met with him alone.[98] The government contended that the attorney discussed the FBAR filing requirements with both Fariba and Saeed, while Fariba asserted that this discussion took place only between the attorney and Saeed.[99]

Saeed and Fariba used a CPA to preprare their joint federal income tax returns for 2003 through 2008. Fariba gave information about her income and expenses related to her insurance business to Saeed who then provided them to the CPA. On Schedule B of the returns, the box was checked "No" in response to the question whether the Cohens owned foreign bank accounts, and the returns reported no foreign income.[100]

Saeed was concerned about potential criminal prosecution for failure to report the foreign accounts and, in June 2011, after the divorce was already in process, Saeed and Fariba entered the IRS Offshore Voluntary Disclosure Initiative ("OVDI").[101] Saeed completed the OVDI and ultimately paid over $25 million of taxes and penalties, including a 50% FBAR penalty. Fariba, however, opted out of the OVDI in the hopes of limiting her liability for the huge willful civil FBAR penalties and any past due taxes on the foreign accounts. Fariba filed delinquent FBARs for 2006 through 2008 on her own, outside of the OVDI, reporting her ownership or authority over various foreign bank

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95 *Id.* at **2-3.

96 *Id.* at *2.

97 *Id.*

98 *Id.* at *2.

99 *Id.*

100 *Id.*

101 This program is no longer in effect. All of the IRS's various iterations of offshore voluntary disclosure programs ended on September 28, 2018.

accounts, including an account at Bank Leumi in Luxembourg. By filing delinquent FBARs outside of the OVDI, Fariba essentially took the position that she did not act willfully in failing to report those accounts, and she obviously hoped to pay only non-willful civil FBAR penalties. Nevertheless, the IRS asserted that Fariba was willful in failing to file FBARs for years when she was married to Saeed, and assessed a willful civil FBAR penalty of over $1.5 million for 2008.[102]

The court deciding Fariba's case agreed with other decisions that willfulness under the civil FBAR penalty statute includes recklessness and willful blindness, but examined these standards separately.[103] The court ruled that it could not "determine *as a matter of law* that [Fariba] recklessly violated the FBAR requirement,"[104] pointing to conflicting evidence: While evidence suggested that Fariba was involving in opening the Bank Leumi account, she disputed that she knew it was a foreign account, because Saeed had domestic accounts at Bank Leumi; and the parties disputed whether Saeed signed Fariba's signature on paperwork regarding the foreign bank accounts. It was also disputed whether Fariba could easily have accessed the 2008 joint tax return because, while Fariba did interact directly with the CPA on several occasions, she asserted that Saeed controlled her ability to do so, and that she neither reviewed nor signed the return.[105] For the court to decide whether Fariba acted recklessly, it would have to make a determination of her credibility, which it could not do on summary judgment.[106]

For similar reasons, the court held that it could not determine as a matter of law that Fariba was willfully blind to the FBAR requirement. The government emphasized that Fabriba went to college and ran a successful insurance business, she allegedly was "long included in the family finances," and she had signature authority over numerous foreign bank accounts with significant balances; consequently "the only way that [Fariba] could have avoided learning of the FBAR requirements was to

102 *Id*.
103 *Id*. at *6.
104 *Id*. (emphasis in original).
105 *Id*.
106 *Id*. at ** 1,8.

make a conscious effort to avoid learning of them."[107] Fariba, on the other hand, disputed "whether she even had an opportunity to learn about the FBAR filing requirements," because Saeed controlled her ability to interact with the CPA, who dealt almost exclusively with Saeed, and because Saeed controlled all the couple's finances and was abusive during the marriage. The court concluded: "Because there are factual issues about recklessness, it is hardly surprising that there are factual issues about willful blindness."[108]

Some take-aways from these two divorce-related cases are that, first, it is possible for divorcing spouses to deal with unreported foreign accounts separately, with one making a voluntary disclosure and the other taking his or her chances with the IRS. Second, evidence that a husband controlled the couple's finances, including foreign bank accounts and foreign entities; signed the wife's name on foreign bank account documents; and limited the wife's access to the couple's CPA, *may* suffice to avoid willful civil FBAR penalties (the wife's testimony in *Cohen* to this effect at least precluded summary judgment).[109] Third, an ex-wife's testimony that she opened a foreign account to protect funds from her very abusive ex-husband may mean that opening the account does not evidence a willful attempt to hide assets from the IRS. Finally, at some point, a divorce is so far in the past that even an ex-wife who relied on her ex-husband in all financial matters for decades cannot use this fact as evidence to support a claim of non-willfulness when facts subsequent to the divorce belie that claim.

IV. The Willful Civil FBAR Penalty Does not Apply Jointly and Severally, but May Apply Separately to Both Spouses

It is important to distinguish FBAR penalties from income taxes, tax penalties, and interest, which apply jointly and severally to both spouses who file a joint tax return, unless one spouse

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[107] *Id.*

[108] *Id.*

[109] There is no subsequent available decision about whether Fariba was in fact found to be willful.

can claim protection as an "innocent spouse."[110] Non-willful and willful civil FBAR penalties do not necessarily apply to both spouses, however. The IRS recognizes that: "There is no joint and severable liability with FBAR penalty cases."[111] Prior IRS guidance provided in greater detail: "FBAR penalties apply and are assessed individually and not jointly (there should only be one individual under examination per FBAR case file). Married couples under FBAR examination are treated as individual cases."[112]

Because the willful civil FBAR penalty is based on *an individual's* knowing or reckless and/or willfully blind failure to comply with the FBAR filing requirements, the same penalty clearly cannot be imposed jointly on another individual who was not knowing or reckless and/or willfully blind. In *United States v. Schwartzbaum,* for example, the court held that to be liable for the willful civil FBAR penalty, a "*person* must have willfully failed to disclose the account and file a FBAR."[113]

On the other hand, the IRS can obtain two civil FBAR penalties—one from each spouse—for each spouse's failure to report a single jointly-held foreign account. This is true for both the non-willful and the willful civil FBAR penalties. In *Jarnagin v.*

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110 I.R.C. § 6015 (2019).

111 IRM § 8.11.6.2(11) (Sept. 27, 2018). *Cf.* IRM § 4.26.17.2.4(1) (Dec. 11, 2019) ("If an FBAR examination is initiated, the examiner will set up a separate FBAR case file, one for each individual/entity under FBAR exam. *A separate case file is required for each spouse under FBAR examination.*") (emphasis added); IRM § 4.26.17.3.1.3(5) (Dec, 11, 2019) (If the IRS seeks a taxpayer's consent to extend the FBAR statute of limitations: "Consent should be prepared separately for each US person for whom the examination is being conducted (even for spouses filing joint income tax returns)").

112 IRM § 8.11.6(5) (2013). *See also* IRM § 8.11.6.4(3), Note (Sept. 27, 2018) ("Married couples under FBAR examination are treated as individual cases and an extension [of the six-year statute of limitations] must be obtained from each individual under examination."); IRM § 8.11.6.4(1), Note (Sept. 27, 2018) ("The FBAR penalty is assessed separately and *not* jointly. There should be *one* individual under examination per FBAR case file.") (emphases in original).

113 No. 18-cv-81147-BLOOM/Reinhart, 2019 WL 3997132 at *3 (S.D. Fla. Aug. 23, 2019) (emphasis added). This was a prior decision to *United States v. Schwartzbaum* discussed above; the court denied Schwartzbaum's motion for summary judgment that he was not subject to the willful civil FBAR penalty.

United States,[114] which involved non-willful civil FBAR penalties, the IRS "asserted that the Jarnagins were liable for the 'Report of Foreign Bank and Financial Accounts (FBAR) penalty' for 2006, 2007, 2008, and 2009, and demanded payment of $40,000 *each* from Mr. and Mrs. Jarnagin."[115] In *Cohen*, discussed above, the court addressed whether Fariba Cohen was personally liable for a willful civil FBAR penalty for 2008, including for not reporting at least one account held jointly with Saeed Cohen, the Bank Leumi account, even though this account was presumably reported on Saeed's delinquent FBARs as part of his OVDI submission, which included 2008. Whatever Saeed might have reported on his delinquent FBARs had no effect on the IRS's assessment of a willful civil FBAR penalty against Fariba, regardless of whether she in fact owned only a half interest in the account, because the willful civil FBAR penalty is based on 50% "of the balance" in an unreported account, without reference to a taxpayer's percentage ownership of the account.[116]

The IRS confirms: "There may be multiple civil FBAR penalties if there is more than one account owner, or if a person other than the account owner has signature or other authority over the foreign account. Each person can be liable for the full

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114 134 Fed. Cl. 368 (Fed. Cl. 2017).

115 *Id*. at 374 (emphasis added). The Jarnagins did not allege that this double imposition of penalties was incorrect, but instead argued (unsuccessfully) that they were eligible for the reasonable cause exception.

116 *Cohen*, 2018 WL 6318837 at *5; *See also* IRM § 4.26.16.4.4 (Nov. 6, 2015) (emphasis added):

FBAR Filing by Married Couples

(1) Accounts owned jointly by spouses may be filed on one FBAR. The spouse of an individual who files an FBAR is not required to file a separate FBAR if the following conditions are met:

a. All the financial accounts that the non-filing spouse is required to report are jointly owned with the filing spouse

b. The filing spouse reports the jointly owned accounts on a timely, electronically filed FBAR.

c. Both spouses complete and sign Part I of FinCEN Form 114a, Record of Authorization to Electronically File FBARs. . . .

(2) If these conditions are not met (as when both spouses have individual accounts in addition to the jointly-owned accounts), both spouses are required to file separate FBARs, *and each spouse must report the entire value of the jointly-owned accounts*.

amount of the penalty."[117] Accordingly, while there is no joint and several liability for FBAR penalties, there can be two separate penalties, one for each spouse.

V. Options for Handling Unreported Foreign Bank Accounts During a Divorce

When an unreported foreign bank account surfaces in a divorce, it cannot be ignored. At a minimum, the taxpayers must start reporting the account correctly on their current year's tax return. Otherwise, the taxpayers will be committing crimes each April 15th by intentionally filing false current and future years' tax returns. Further, the taxpayers' lawyers, advisors, and tax return preparers will now know that there are unreported foreign accounts, and it would be unethical, or even criminal, for a professional to participate (or conspire) in the failure to report the account on the current year's return. Tax return preparers in particular will have no choice other than to either ensure the account is reported,[118] or withdraw from representing the taxpayers

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117 IRM § 4.26.16.6(6) (Nov. 6, 2015).

118 *See* Treas. Dep't. Circular 230 (June 2014), *Regulations Governing Practice Before the Internal Revenue Service* ("*Circular 230*") § 10.34(a) (effective for returns filed beginning Aug. 2, 2011) ("A practitioner may not willfully [or] recklessly . . . [s]ign a tax return that the practitioner knows or reasonably should know contains a position that . . . [l]acks a reasonable basis"). *See also Circular 230* § 10.21 "Knowledge of client's omission.":

> A practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission.

See also Treas. Dep't, *Guidance to Practitioners Regarding Professional Obligations Under Treasury Circular No. 230, Selected Obligations Under Treasury Circular No. 230* (Aug. 2015) https://www.irs.gov/pub/irs-utl/guidance_regarding_professional_obligations_under_circular_230.pdf ("*Errors and Omissions*. . . [citing *Circular 230* § 10.21, and elaborating:] Depending on the particular facts and circumstances, the consequences of an error or omission could include (among other things) additional tax liability, civil penalties, interest, criminal penalties, and an extension of the statute of limitations."); ("*Tax*

completely.[119]

The real question is what to do about the past non-compliance on prior years' returns. Fixing the past failure to report can be sensitive, time-consuming, and very expensive in terms of fees, taxes, and penalties. So, many spouses will prefer to let sleeping dogs lie and wait to see if the IRS ever discovers the unreported bank account. This can be a very risky approach, however, because the IRS has become adept at finding unreported foreign bank accounts and regularly collects information from foreign financial institutions about United States depositors.[120] Also, because the taxpayer must report the foreign account on the current year and future years' returns, the taxpayers

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Return Positions. You cannot sign a tax return . . . or advise a client to take a position on a tax return . . . that you know or should know, contains a position . . . for which there is no reasonable basis; . . . or . . . which is . . . a reckless or intentional disregard of rules or regulations.") (emphases in original).

119 AICPA Tax Section, *Statements on Standards for Tax Services No. 6, Knowledge of Error: Return Preparation and Administrative Proceedings*, Explanation ¶ 12:

> If a member . . . is requested to prepare a tax return for a year subsequent to that in which [an] error occurred, the member should take reasonable steps to ensure that the error is not repeated. If the subsequent year's tax return cannot be prepared without perpetuating the error, the member should consider withdrawal from the return preparation.

See also Joseph J. Tapajna, *Ethics Rule Would Require CPAs to Discuss Suspected Illegal Acts with Clients*, AICPA, Tax Advisor (Feb. 1, 2018) (noting that proposed rules would require an AICPA member "who determines that a client's illegal or suspected illegal conduct is significant, and the client refuses "to take appropriate steps to address the matter," must "consider whether withdrawal from the engagement or client relationship is necessary, or whether he or she needs to take further, more serious action"); *Cf.* I.R.C. § 6694(b) (2015) (imposing a minimum penalty of $5,000 on a tax return preparer who prepares a return "with respect to which any part of an understatement of liability is due to . . . "a willful attempt in any manner to understate the liability for tax on the return . . . or . . . a reckless or intentional disregard of rules or regulations").

120 The Foreign Asset Tax Compliance Act ("FATCA") requires foreign financial institutions ("FFI"s) to scrub their records to determine whether any accounts have United States indicia, such as a U.S. passport, address, telephone number, etc. If the FFI determines that an account holder may be a U.S. person, it must report this to the IRS. A noncompliant FFI is subject to a 30% withholding tax on payments of interest "or other fixed or determinable annual or periodical gains, profits, and income" from the United States. I.R.C. § 1471 (a),(b) & (c) (2010).

themselves will be giving the IRS notice of the foreign account. Under these circumstances, waiting to see if the IRS will impose civil FBAR penalties, or worse, start a criminal investigation, is like embedding a ticking time bomb into the couple's divorce decree. The better course is to directly address the problem of the unreported foreign bank account and allocate the resulting liability (as well as the remaining asset) between the parties.

There are several ways to address the prior years' tax returns and failure to report the foreign accounts. One way is to quietly file amended tax returns with the necessary schedules and quietly file the past due FBARs. The problem with this approach is that, if the IRS detects the amended returns or the newly-filed FBARs, the chance of an audit and resulting penalties is very high. Fortunately, the IRS has provided other options for taxpayers who wish to come in from the cold and report their previously undisclosed foreign accounts.

The first set of options is for taxpayers who are certain that their failure to report the foreign account was not willful or reckless under the case law discussed above. These taxpayers may use a series of programs that the IRS has established to accept corrections of "innocent" failures to report, including the Streamlined Filing Compliance Procedures and the Delinquent FBAR Reporting Procedures.

The United States has also entered into numerous intergovernmental agreements ("IGAs") to further the purposes of FATCA. The IGAs broadly take two forms. Under a "Model 1" IGA, a foreign government agrees to collect the financial information that FATCA would otherwise require FFIs to report, and the foreign government itself reports that information directly to the IRS; any FFI within that jurisdiction that sends accountholder information to the foreign government "shall be treated as complying with" FATCA. *See* U.S. Treasury, *Agreement Between the Government of the United States of America and the Government of [FATCA Partner] to Improve International Tax Compliance and to Implement FATCA* (Nov. 30, 2014), https://home.treasury.gov/system/files/131/FATCA-Reciprocal-Model-1A-Agreement-Preexisting-TIEA-or-DTC-11-30-14.pdf.

Under a "Model 2" IGA, the foreign government agrees to modify its bank privacy laws to the extent necessary to enable its FFIs to report their United States account information directly to the IRS. *See* U.S. Treasury, *Agreement Between the Government of the United States of America and the Government of [FATCA Partner] to Improve International Tax Compliance and to Implement FATCA* (Nov. 30, 2014), https://home.treasury.gov/system/files/131/FATCA-Model-2-Agreement-Preexisting-TIEA-or-DTC-11-30-14.pdf.

A. *The Streamlined Filing Compliance Procedures*

The Streamlined Filing Compliance Procedures ("Streamlined Procedures") provide a simplified way for a taxpayer who did not willfully fail to report a foreign account and who is not already under audit to come into compliance with a minimal penalty. Note, however, that the IRS has stated that it may terminate these procedures at any time.

Currently, there are two different Streamlined Procedures: one for taxpayers who reside in the United States[121] and one for non-U.S. resident taxpayers.[122] The program for residents allows taxpayers to file only three years of amended tax returns and six years of past-due FBARs. Taxpayers who qualify for this program will owe a limited penalty equal to 5% of the highest balance of their unreported foreign assets during the preceding six years. The program for non-resident taxpayers also requires three years of amended returns and six years of past due FBARs, but is even more forgiving, imposing no penalty at all.[123]

There are, however, two extremely important limitations on participation in the Streamlined Procedures. First, the taxpayers must not have already been contacted by the IRS. Second, a taxpayer must be able to certify, under penalties of perjury, that she did not willfully fail to report her foreign account.[124] Indeed, a taxpayer is required to explain in detail all the facts and circumstances surrounding the foreign account to establish that her failure to report was not willful.[125] This non-willful certification is an

121 *See* IRS, *U.S. Taxpayers Residing in the United States* (Jan. 15, 2020), https://www.irs.gov/individuals/international-taxpayers/u-s-taxpayers-residing-in-the-united-states.

122 *See* IRS, *U.S. Taxpayers Residing Outside the United States* (Sept. 19, 2020), https://www.irs.gov/individuals/international-taxpayers/u-s-taxpayers-residing-outside-the-united-states.

123 The reasoning is that taxpayers who have not lived in the United States have less reason to know about United States tax filing requirements and so their non-willful violations of the FBAR reporting rules should not be subject to penalties.

124 For U.S. residents, the certification is made on IRS Form 14654, https://www.irs.gov/pub/irs-pdf/f14654.pdf. Non-U.S. residents use IRS Form 14653, https://www.irs.gov/pub/irs-pdf/f14653.pdf.

125 Both IRS Form 14654 and IRS Form 14653 require a taxpayer to "[p]rovide specific reasons for your failure to report all income, pay all tax," and to "[i]Include the whole story including favorable and unfavorable facts."

integral part of the Streamlined Procedures, but it may be challenging given the expanded definition of willfulness outlined in the court decisions described above. The IRS reserves the right to audit streamlined submissions and challenge the certification of willfulness.[126] There is always a chance that the IRS will disagree with the certification and attempt to assert the 50% willful civil FBAR penalty or even initiate a criminal prosecution.

B. *The Delinquent FBAR Submission Procedures*

There is an even more lenient path to compliance for taxpayers who completely failed to file prior year's FBARs but do not owe any additional tax for those prior years, and who have an excuse for why they did not file the FBARs. Taxpayers in this enviable situation, who have not already been contacted by the IRS, can simply file past-due FBARs for the preceding six years together with a statement explaining why they are filing the FBARs late, and the IRS will not impose any penalties for the delinquent FBARs.[127] This forgiving program is very limited in scope, available only to taxpayers who reported all income and paid all tax and simply missed the requirement to file a separate FBAR. As with the Streamlined Procedures, the IRS reserves the right to audit the taxpayer and determine whether he or she really qualifies for no penalty.

C. *The Voluntary Disclosure Practice*

A third option is available to taxpayers who do not qualify for the foregoing programs and are concerned that a court could find that they willfully failed to file their required FBARs. If there is a real risk that one or both spouses willfully failed to report a foreign account, they should seriously consider using the

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A taxpayer must include a description of her personal and financial background; explain the source of funds in her foreign financial accounts; and explain her "contacts with the account/asset including withdrawals, deposits, and investment/management decisions." And, if the taxpayer relied on a professional advisor, she must provide their name, address, "and a summary of the advice."

[126] *See U.S. Taxpayers Residing in the United States, supra* note 121.

[127] *See* IRS, *Delinquent FBAR Submission Procedures* (Sept. 30, 2020), https://www.irs.gov/individuals/international-taxpayers/delinquent-fbar-submission-procedures.

IRS Voluntary Disclosure Practice ("VDP"). The VDP provides protection against potential criminal prosecution and is primarily for taxpayers who fear prosecution.[128] However, even if the taxpayer does not fear criminal prosecution for some reason, the VDP may also be the best option to limit civil penalties for taxpayers who were clearly willful and fear that that the IRS may impose particularly severe willful civil FBAR and tax penalties.[129]

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128 *See* IRS, *IRS Criminal Investigation Voluntary Disclosure Practice* (Oct. 20, 2020), https://www.irs.gov/compliance/criminal-investigation/irs-criminal-investigation-voluntary-disclosure-practice ("Taxpayers who participate in the Voluntary Disclosure Practice intend to seek protection from potential criminal prosecution. If your violation of the law was not willful, you should consider other options including correcting past mistakes by filing amended or past due returns.") *See also* Instructions for Form 14457, Voluntary Disclosure Practice Preclearance Request and Application ("Form 14457 Instructions") at 7 ("You should not use the IRS-CI Voluntary Disclosure Practice if you did not commit any acts that rise to the level of tax or tax-related crimes.")

While the IRS states that a "voluntary disclosure will not automatically guarantee immunity from prosecution," because the IRS does not want to bind itself in the event that facts warranting prosecution later come to light, it also states that the objective of the VDP is to provide taxpayers with "a means to come into compliance with the tax law and avoid potential criminal prosecution." Form 14457 Preclearance Instructions at 6. *See also* IRM § 9.5.11.9(i) & (ii) (Sept. 17, 2020) ("Voluntary Disclosure Practice").

A taxpayer who made a voluntary disclosure of foreign bank accounts under the various iterations of the prior IRS Offshore Voluntary Disclosure Program ("OVDP"), which ended on September 28, 2018, is "not eligible to use the IRS-CI Voluntary Disclosure Practice where the OVDP disclosure period includes one or more overlapping tax years with the IRS-CI Voluntary Disclosure Practice disclosure period," which is six years. Form 14457 Instructions at 7.

In addition, "[t]axpayers that made any prior voluntary disclosure will be subject to enhanced review by IRS-CI to determine whether accepting another voluntary disclosure violates the requirement of compliance following the disclosure period." IRM § 9.5.11.9.4 (Sept. 15, 2020).

129 *See* IRM § 4.26.16.6.5.3 (Nov. 6, 2015) ("Penalty for Willful FBAR Violations – Calculation") ("For cases involving willful violations over multiple years, examiners may recommend a penalty for each year for which the FBAR violation was willful.") *But see* IRM Exhibit 4.26.16-1 ("FBAR Penalty Mitigation Guidelines for Violations Occurring After October 22, 2004") ("manager approval is required to assert willful penalties that, in the aggregate, exceed 50% of the highest aggregate balance of all accounts to which the violations relate during the years at issue, and in no event can the aggregate willful penal-

One of the primary benefits of the VDP is that it limits the look-back period for assessing taxes and penalties to six years.[130] In addition to all the tax and interest due on unreported foreign income, penalties under the VDP include a one-time willful civil FBAR penalty equal to 50% of the highest balance in undeclared accounts during the six-year disclosure period. The IRS does retain the discretion to apply less than the maximum penalty in unusual cases.[131] In addition to the willful FBAR penalty, the IRS also will impose a civil fraud penalty of 75% of the tax due on the year with the highest tax deficiency, in lieu of any other accuracy-related penalties and delinquency penalties.[132] There will also be estimated tax penalties. Penalties for failure to file information returns (such as IRS Form 5471[133] and IRS Form 8938[134]) can be imposed at the IRS examiner's discretion.[135]

Taxpayers seeking to enter the VDP must first obtain "preclearance" by submitting IRS Form 14457-Part I, to allow IRS Criminal Investigation ("IRS C-I") to determine whether the taxpayer is eligible to make a voluntary disclosure. The most

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ties exceed 100% of the highest aggregate balance of all accounts to which the violations relate during the years at issue").

130 Form 14457 Instructions, *supra* note 128, at 9.

131 IRM § 4.26.16.6.5 (Nov. 6, 2015) ("Penalty for Willful FBAR Violations"). An IRS examiner has discretion not to impose the maximum civil willful FBAR penalties, after consideration of "all the available facts and circumstances of the case[.]" IRM § 4.26.17.3.6 (Dec. 11, 2019) ("Penalty Application").

132 Form 14457 Instructions, *supra* note 128, at 6,8.

133 *Information Return of U.S. Persons with Respect to Certain Foreign Corporations*, *supra* note 6.

134 *Statement of Specified Foreign Financial Assets*, *supra* note 4.

135 Form 14457 Instructions, *supra* note 128, at 8. An IRS memorandum that expired on November 20, 2020 indicated that a taxpayer could request that accuracy-related penalties be imposed instead of a civil fraud penalty, or non-willful civil FBAR penalties instead of willful penalties, but the memorandum stated that these requests would only be granted in exceptional circumstances. See Dep't of the Treasury, Nov. 120,2018Memornadum for Division Commissioners, Chief, Criminal Investigation (Expiration date: Nov. 20,2020), Control Number: LB&I—09-118-014 ("Expired *Nov. 20, 2018 Mem.*"), discussed in Isabelle Farrar & Hyungjoon Hah, *IRS Announces Voluntary Disclosure Program For Domestic and Offshore Assets* (Monday Feb 12, 2019), 2019 WLNR 5335004. Current IRS authority governing the VDP, i.e. the IRM. and Form 14457 Instructions, however, do not mention the possibility of a taxpayer seeking lesser penalties.

important factor in determining eligibility is "timeliness," meaning the taxpayer must "come forward before the IRS has information about [the taxpayer's] noncompliance."[136] It is too late to make a voluntary disclosure if either spouse, or any related entity, has been notified that the IRS or other law enforcement authority intends to initiate an audit or criminal investigation.[137] In addition, a taxpayer cannot make a voluntary disclosure if income to be reported is from illegal sources.[138] Failure to pay tax on or otherwise report income earned on foreign accounts does not mean that this income is from an illegal source.

The IRS will provide written notification of a preclearance request's approval or denial, after a minimum of thirty days but possibly much longer.[139] Once a taxpayer receives preclearance approval, she must apply for preliminary acceptance into the VDP. (Final acceptance only comes when an agreement is reached at the conclusion of a VDP examination.) A taxpayer applies for preliminary acceptance by submitting Form 14457-Part II, which is signed under penalties of perjury. Among other things, the taxpayer must estimate the unreported income and the highest balances in any unreported foreign account during the disclosure period. The taxpayer must also provide a comprehensive written narrative that details the whole story of her willful tax or tax-related noncompliance.[140] Married taxpayers submitting a joint Form 14457 must "indicate the intention to dis-

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[136] Form 14457 Instructions, *supra* note 128, at 11. *See also* IRM § 9.5.11.9.1(3) (Sept. 17, 2020) ("Voluntary Disclosure Process").

[137] Form 14457-Part I, line 9.

[138] Form 14457 Instructions, *supra* note 128, at 7. Note that: "Income from activities determined to be legal under state law but illegal under federal laws is considered illegal source income for purposes of the IRS-CI Voluntary Disclosure Practice."

[139] Form 14457 Instructions, *supra* note 128, at 11.

[140] The narrative must include "specific facts that detail the complete story of the willful tax or tax-related noncompliance" and "must truthfully and in complete detail explain your noncompliance from inception to the present." A taxpayer must describe her personal background, including "age, health, education, and general financial history"; and summarize her work and business experience. Form 14457 Instructions, *supra* note 128, at 11, line 7. A taxpayer must also identify professional advisors "who aided in your willful noncompliance." *Id.*

closure jointly and specify where facts are unique to each spouse."[141]

If IRS-CI approves the taxpayer to participate in the VDP, it will provide the taxpayer with a Preliminary Acceptance Letter and forward the Form 14457 to an IRS civil section. An IRS examiner will then contact the taxpayer to start an examination.[142] This process can take several months. At the end of the VDP examination, the taxpayer may request IRS Appeals review of the IRS examiner's assessment of tax and penalties.[143] The VDP is complete when the examination is complete, any appeal has been resolved, and the taxpayer signs a closing agreement and pays or makes arrangements to pay the full amount of tax, penalty and interest determined to be due. A taxpayer who is unable to make full payment may request in advance that the IRS consider other payment arrangements, such as an installment plan.[144]

A taxpayer participating in the VDP must be truthful and make full disclosure of all facts regarding her noncompliance. She must file FBARs and provide proof of their electronic filing. And a taxpayer must not only cooperate with the IRS in determining her tax liability and reporting requirements but must also cooperate in an IRS investigation of "any professional enablers who aided in the noncompliance."[145] If a taxpayer does not cooperate fully, or provides materially false information during the VDP, her preliminary acceptance may be revoked, and her case may be referred back to IRS-CI for potential prosecution.[146] Or

141 Form 14457 Instructions, *supra* note 128, at 13.

142 IRM § 9.5.11.9.2(5) (Sept. 17, 2020) ("Designated Criminal Investigation Employees").

143 The Expired *Nov. 20, 2018 Mem.*, *supra* note 135 provided that: "Taxpayers retain the right to request an appeal with the Office of Appeals." The current IRM and Form 14457 Instructions, however, do not mention this right. The IRM provides that IRS-CI's decisions concerning timeliness, completeness, truthfulness, rejection, and revocation of a voluntary disclosure are not subject to administrative or judicial review, 9.5.11.9(4) (Sept 17, 2020), but does not mention administrative review of the examiner's conclusions at the end of a voluntary disclosure civil examination.

144 Form 14457 Instructions, *supra* note 128, at 9.

145 *Id.* at 11.

146 *Id.* at 11. *See* also IRM § 9.5.11.9.7(1) (Sept. 17, 2020) ("Revocation of Voluntary Disclosure") ("If it is determined that the taxpayer provided materially false information, the matter will be referred to CI for criminal evaluation

the examiner may expand the examination to include *all tax years* where there was willful noncompliance and apply all applicable penalties to all those years.[147]

Finally, while tax owed on joint returns is joint and several, if one spouse refuses to enter the VDP and the second spouse fears criminal liability, the second spouse may enter the VDP alone, although the IRS discourages this.[148] Then, if taxes and penalties determined to be owed at the end of a VDP examination are not paid in full by the spouse who entered the VDP, an agreement closing the VDP must be signed by both spouses[149] or, if the first spouse refuses to sign the agreement, the IRS will assess each spouse separately.[150] The bottom line is that a spouse who refuses to enter into a joint VDP submission may not end up avoiding liability for the taxes and penalties based on unreported foreign accounts during years when she filed joint returns with her spouse.

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and possible criminal investigation via the fraud referral process."). Note that: "IRS-CI's determinations, including but not limited to determinations concerning timeliness, completeness, truthfulness, rejection, and revocation decisions, are not subject to any administrative or judicial review or appeal process." IRM § 9.5.11.9(4) (Sept. 17, 2020) ("Voluntary Disclosure Practice").

147 Form 14457 Instructions, *supra* note 128, at 9.

148 "A spouse whose conduct was not willful is not required to make a voluntary disclosure but making a joint disclosure will ease the burden of a subsequent civil examination." *Id.* at 10 ("Joint Returns and Disclosures").

149 *Id.* ("When only one spouse enters an agreement and full payment is not received, there will be administrative delays and extra compliance burdens.")

150 *Id.*; *See also* IRM § 4.10.8.5.4 (Aug. 11, 2006) ("Waiver of Assessment for Joint Returns") ("When full payment is not received, and only one spouse signs the waiver, unagreed procedures should be followed for the non-signing spouse."); IRM § 4.10.8.2.4.2(3) (Sept. 13, 2019) ("Execution and Receipt of Audit Reports and Waivers") (same).

The "unagreed procedures" for the non-signing spouse will involve sending an IRS "30-Day Letter" to advise her of the outstanding liability and of the right to appeal to IRS Appeals. IRM § 4.10.8.13 (Sept. 13, 2019) ("Unagreed Case Procedures: Preliminary (30-Day) Letters (LB&I Examiners only)"); *see also* IRM § 4.10.8.12 (Sept. 13, 2019)("Unagreed Case Procedures (SB/SE Field and Office Examiners only)")(essentially the same).

VI. Steps for Deciding How to Handle an Undisclosed Foreign Account in a Divorce

While discovering an unreported foreign bank account during a divorce proceeding can heighten tensions, create confusion, and pose significant risks for the parties, there is an organized way to address the problem. Of course, this will require a certain amount of cooperation and may take time and money to resolve.

A. *First, Determine Whether the Failure to Report Was Willful*

The first and most important task after discovery of an unreported foreign account is to determine whether the taxpayers' failure to report could be considered willful under the standards outlined above. If it is clear that one or both spouses knew of the account and intentionally failed to include it on the tax return, there is a chance of criminal prosecution. In this case, the problem is very sensitive and the solution is likely to be expensive. Experienced outside counsel should be consulted.

If it is not clear that either spouse actually knew that the foreign account had to be reported, but there is a real risk that one or both spouses were "reckless," including by signing a joint return which answered the question about a foreign account by checking the box "No" (although, as discussed above, this alone may not be sufficient evidence of recklessness), there is a lesser risk of criminal prosecution, but large willful civil FBAR penalties still may apply.[151] Without the threat of prosecution, the decision of whether to correct the past non-compliance and how to do so becomes a "cost/benefit analysis" based on how best to reduce potential economic exposure.

B. *Second, Determine the Best Way to Correct the Prior Years' Non-Compliance*

An evaluation of whether the failure to report a foreign account was willful is necessary to determine the best way to address the non-compliance. As noted above, simply ignoring the problem altogether is not an option. And it almost never makes sense to simply file amended tax returns and past due FBARs

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151 See *supra* discussion of penalties in text at notes 26-30, and discussion of recklessness in text at notes 47-58 and 69-73.

without using one of the IRS programs discussed above, because these programs are designed to provide some protection and penalty relief.

If the taxpayers were clearly not willful (including not being reckless), depending on their facts, they may choose either the Streamlined Procedures or the Delinquent FBAR Procedures. A domestic taxpayer who owes taxes for the prior years but has reasonable cause for failure to report the foreign account may use the Streamlined Procedures and pay the 5% penalty. If no taxes are owed and a taxpayer simply failed to file FBARs, the taxpayer may be eligible for the Delinquent FBAR Procedures and the problem can be fixed with no penalties at all.

In cases where one or both spouses were obviously willful, and particularly where criminal prosecution is possible, the VDP will clearly be the best choice since it provides protection against prosecution and some certainty as to civil penalties. While the civil penalties imposed by the VDP are significant, even higher civil penalties could be imposed if the taxpayer were simply to file amended returns and delinquent FBARs, thereby running a material risk of an examination outside any IRS program and with no limitations on penalties.

C. *Finally, Determine How to Allocate the Tax Liability in the Divorce Proceedings*

The VDP will result in significant taxes and penalties for the parties. The Streamlined Procedures will be much less costly. Either way, however, there will be a tax bill to be paid to the IRS. Both programs require payment, but the IRS may allow payment over time if the taxpayers can prove that they do not have sufficient assets to pay the bill immediately. In a divorce, this will require agreement regarding which spouse will make these payments (or if they will be made jointly) and for how long these payments will be made.

As noted, in most cases, the liability for taxes due on a joint return will be joint and several, but the large willful civil FBAR penalty will be specific to either one or both spouses, which may raise difficult issues in a divorce. If both spouses participate in the VDP, the IRS is typically ambivalent about which spouse pays the taxes and penalties so long as they are in fact paid. However, if there is a chance that the taxes and penalties will not

be paid immediately as part of the VDP or the Streamlined Procedures, then the IRS will want both spouses to be liable.

If one spouse refuses to agree to the liability for taxes and penalties, the non-cooperative spouse will be considered to be outside whichever IRS program they both, or the other spouse, entered. In such cases, the IRS is very likely to audit the non-cooperative spouse and will consider imposing penalties that will not be limited by the terms of the IRS programs. This appears to be what happened to Fariba Cohen in the case of *United States v. Cohen* described above.[152] Mrs. Cohen withdrew from the VDP in the hope that she could avoid the FBAR penalties, but the IRS audited her and assessed civil willful FBAR penalties against her that would have been smaller if she had cooperated with her spouse inside the VDP, and the court upheld those penalties. Thus, there is significant risk for a spouse who does not cooperate in a disclosure if she or he had a significant connection to the account and might be determined to have willfully failed to report the account—but, if this risk is explained clearly to the spouse who does not want to cooperate, it may offer an incentive for that spouse to agree to a coordinated strategy in the divorce.

Regardless of which spouse actually pays the taxes and penalties to the IRS, the obligations to the IRS should be considered to be a liability of the marital estate, just like any other liability.[153] Matrimonial courts typically are not bound by IRS rules, nor by how the IRS goes about assessing and collecting taxes and

152 See *supra* discussion in text at notes 101-02, 116.

153 *See*, *e.g.*, Barrow v. Barrow, 716 S.E.2d 302, 307 (S.C. Ct. App. 2011) (ruling that where the wife "benefited from at least 50% of the total marital income," she was liable for 50% of an "original tax liability incurred during the marriage"); Meints v. Meints, 608 N.W.2d 564, 569 (Neb. 2000) ("[i]ncome tax liability incurred during the marriage is one of the accepted costs of producing marital income, and thus, we hold that income tax liability should generally be treated as a marital debt"); Capasso v. Capasso, 517 N.Y.S.2d 952, 968-69 (N.Y. App. Div. 1987) ("[v]iewing marriage as an economic partnership, . . . spouses should share . . . liabilities as well as assets incurred in the pursuit of marital wealth"; a wife benefitted from monies accumulated through illegal acts charged in an indictment against the husband alone, so "any taxes and interest that may be assessed against either or both of the parties . . . shall be paid and borne equally by them"). *Cf.* Repka v. Repka, 588 N.Y.S.2d 39, 41-42 (N.Y. App. Div. 1992) (deciding that the proceeds of sale of one spouse's business would be divided equally but only after all applicable taxes owed by either spouse were paid).

penalties, and a state court is free to allocate the liability between the spouses as it sees fit.[154] Accordingly, the best course may be for the taxpayers to cooperate in minimizing the liability with respect to the IRS, and then present their separate cases to the matrimonial court to argue why one or the other should be more or less accountable for the liability arising from an unreported foreign account.

Conclusion

Unreported foreign bank accounts can create uncertainty, tension, and significant risk during the divorce process. Nevertheless, there is a straightforward way to proceed: First, determine whether the failure to report was willful. Then, depending on whether the failure was willful, determine how to address the prior non-compliance; if done correctly, the parties can avoid the chance of criminal prosecution and minimize the taxes and civil penalties that will inevitably be due to the IRS. Finally, estimate the potential cost of correcting the failure to report the account, including fees, taxes, and penalties, and determine how to allocate those costs as part of the resolution of the divorce.

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[154] *See* Estate of Ravetti v. United States, 37 F.3d 1393, 1395 (9th Cir. 1994) (holding that the wife was an "innocent spouse" under federal law, and so not jointly liable for unpaid federal taxes, but federal law did not "control the state law determination of whether, as an equitable matter, [the wife] should have to contribute anything to [her husband]"); *Barrow*, 716 S.E.2d at 307 (determining that while the wife was liable for 50% of a tax liability incurred during the marriage, the husband was solely liable for penalties arising from his failure to file tax returns); *Meints*, 608 N.W.2d at 569 (determining that spouses were jointly liable for unpaid income tax even though they filed separate tax returns, but the wife who filed timely returns was not jointly liable for penalty and interest, which were "properly treated as a nonmarital debt, solely attributable to the husband's late filings"); Barner v. Barner, 716 So. 2d 795, 798 (Fla. Dist. Ct. App. 1998)(ruling that the spouses were required to pay equal amounts toward back taxes owed the IRS, even though they filed separate tax returns, because monies earned by the husband supported the family unit during the dissolution proceeding and the husband "should not be punished because he is the only one who generates income"); *Capasso*, 588 N.Y.S.2d at 42 (holding that although the wife was jointly liable for taxes and interest due on marital wealth from her husband's illegal acts, she was not jointly liable for civil fraud penalties that might be imposed because of acts charged in the indictment against her husband, nor for her husband's criminal fine).