DOJ Secures Verdict in Excess of $2 Million for Failure to File FBARs

By William E. Bonano

On Wednesday, May 28, 2014, a jury in Miami issued a verdict against a taxpayer for $2.2 million in fees, interest, and civil penalties for willfully failing to file foreign bank account reports (FBARs) for his Swiss bank accounts. The penalties amounted to a 150 percent of the maximum value of the account during the years at issue.[1]

Background Facts and Law

U.S. citizens and resident aliens (U.S. Persons) who have an interest in, or signature authority over, financial accounts in a foreign country, such as a bank account or a securities account, are required to disclose the existence of such accounts on Schedule B, Part III of their individual income tax returns.

Additionally, by June 30 of each tax year, U.S. persons must disclose any foreign financial accounts in excess of $10,000 by filing an FBAR with the U.S. Treasury. Taxpayers who fail to file their FBARs by June 30 can be assessed a penalty of up to $10,000. However, if the failure to file was willful, the penalty increases to the greater of $100,000 or 50 percent of the account's balance at the time the violation occurred. This penalty is assessed *each year* that an FBAR was not timely filed.

Case Before the Court

In the 1960s, the defendant, Carl R. Zwerner, opened an account at a Swiss bank that was held at different times in the name of two foundations that he controlled. He regularly used the funds from the account for personal expenses, including European vacations. Nonetheless, for each of the years at issue, 2004 through 2007, he neglected to inform his CPA of the accounts and stated on his tax returns that he did not have a financial interest in, or signature authority over, any financial accounts in a foreign country. Additionally, until late 2007, Zwerner never filed an FBAR with respect to the account with the U.S. Treasury.

[1] U.S. v. Zwerner, 13-cv-22082 (S.D. Fla. 5/28/2014).

In 2009, tax counsel for Zwerner initiated a "traditional" voluntary disclosure[2] with the IRS on an anonymous basis and received a letter from the IRS Criminal Investigation Division that there would be no criminal prosecution related to the failure to disclose the account. At that time, Zwerner amended his previously filed tax returns to declare and pay tax and interest on the account in question. In 2010, the IRS began an audit of Zwerner's returns. Zwerner attempted to enter into the 2011 Offshore Voluntary Disclosure Initiative (2011 OVDI), which was permitted even though he had previously disclosed the account pursuant to a traditional voluntary disclosure, but was ineligible because he was under audit.

In 2013, the IRS brought suit against Zwerner in federal district court for penalties under 31 U.S.C. § 5321 for failure to file FBARs for 2004 through 2007. Despite the fact that Zwerner had made a previous traditional voluntary disclosure, the IRS was not foreclosed from seeking civil penalties because the penalties imposed in connection with a traditional voluntary disclosure were not capped. Penalties are capped under the voluntary disclosure programs announced by the IRS in 2009, 2011 and 2012. The 2011 OVDI that Zwerner attempted to enter into caps penalties at 25% of the value of the offending account.

Jury Verdict

The jury found that the evidence showed Zwerner knew of his obligation to file FBARs, his failure to file FBARs for years 2004 through 2006 was willful, and that the balance of the account for each of the years at issue exceeded $1.4 million. The jury refused to find that the failure to file a timely FBAR was willful in 2007.

The court will determine the final amount of the judgment in June 2014 after hearing arguments regarding whether the penalty imposed is excessive under the 8th Amendment, likely the first time such an argument has been asserted in a tax case.

Implications of the Court's Decision

Takeaways from this case include:

- The Government did not have to show explicit evidence that Zwernerknew of his requirement to file a FBAR, such as previous warnings or punishment. Instead, knowledge was inferred by the jury from the facts that Zwerner:
  - Operated through controlled foundations to conceal assets, changing the name once to hide the assets from his wife;
  - Did not disclose the accounts to his CPA, even after being explicitly asked about overseas accounts;
  - Signed tax returns that contained instructions that explicitly referred to the requirement to file an FBAR; and
  - Instructed the Swiss bank never to send him records in order to keep it a "secret account."
- The Government's burden of proof in a civil case, even one with steep fines and penalties, is less than the "beyond a reasonable doubt" standard used in criminal cases. Instead, the Government is held to a "preponderance of the evidence" standard. This generally requires a showing that the defendant is more likely than not at fault.

[2] A "traditional" voluntary disclosure refers to a voluntary disclosure that was entered into outside of the 2009, 2011 and 2012 Offshore Voluntary Disclosure programs.

- Finally, the facts of the case may provide some insight as to criteria the Government considers when deciding which cases to prosecute. They may include:
  - Account balances each year exceeding $1 million;
  - Amendments to Schedule B's Question 7 (asking about overseas accounts) from "No" to "Yes" outside of a voluntary disclosure program;
  - Personal use of the funds from an undisclosed foreign account; and
  - Use of a foreign foundation to conceal the identity of the US taxpayer.

For those taxpayers with undisclosed offshore accounts under comparable facts, the verdict in this case should provide adequate incentive for such taxpayers to enter into a voluntary disclosure program as soon as possible. While the 2012 Offshore Voluntary Disclosure Program is currently open and remains open indefinitely, the IRS has noted that it may close the program at any time in the future. Moreover, IRS, Treasury and Department of Justice officials have in recent public statements made clear that the government continues to focus resources on FBAR enforcement efforts.

This material is not intended to constitute a complete analysis of all tax considerations. Internal Revenue Service regulations generally provide that, for the purpose of avoiding United States federal tax penalties, a taxpayer may rely only on formal written opinions meeting specific regulatory requirements. This material does not meet those requirements. Accordingly, this material was not intended or written to be used, and a taxpayer cannot use it, for the purpose of avoiding United States federal or other tax penalties or of promoting, marketing or recommending to another party any tax-related matters.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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