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The New Voluntary Disclosure Program

On November 29, 2018, the IRS released new Voluntary Disclosure Practice (“VDP”) procedures, which apply to both domestic and offshore voluntary disclosures submitted after September 28, 2018, and may be applied to domestic voluntary disclosures filed before that date. To participate in the VDP, taxpayers must submit a preclearance request to the IRS Criminal Investigation Division. Once accepted, the taxpayer must prepare a Form 14457 (forthcoming) containing all facts and circumstances relevant to the VDP, along with information on assets, entities, related parties, and professional advisors involved in the taxpayer’s noncompliance. The program covers a six-year disclosure period, but may be expanded by the taxpayer. Taxpayers must submit tax returns and make full payment of taxes, penalties, and interest for the length of their disclosure period. After examining and accepting the taxpayer’s submission, the taxpayer will enter into a closing agreement with the IRS. If the agreement cannot be reached, taxpayers have the right to appeal the results of their program examination with the Office of Appeals.

The new program is primarily tailored for taxpayers who may have criminal exposure and is offered with a hefty penalty structure. While IRS examiners will still have substantial discretion, in general, taxpayers should expect a fraud penalty equal to 75% of the unpaid income tax on the noncompliant year with the highest income. Additionally, examiners will still have the discretion to impose fraud penalties on other years. Taxpayers can also expect a willful FBAR penalty equal to 50% of the undisclosed offshore assets’ value. Taxpayers will be given an opportunity to present evidence to mitigate fraud and willful FBAR penalties, but those should only be expected to be granted in exceptional circumstances. Penalties for failing to file foreign information returns will not be automatically applied, but rather, will be considered by the examiner, taking into account other relevant penalties. Additionally, penalties in connection with estate and gift taxes, employment taxes, and excise taxes will be based on the facts and circumstances of each case.

Cases

*Bedrosian v. United States*, No. 17-3525 (3d Cir. Dec. 21, 2018)

The government appealed the District Court’s determination that Bedrosian’s failure to report one of his accounts on the 2007 FBAR was not willful to the Third Circuit Court of Appeals. On appeal, the Third Circuit focused on two issues of first impression: (1) federal court’s jurisdiction in FBAR cases and (2) the civil “willfulness” standard.

On the question of jurisdiction, the Third Circuit considered whether the District Court had jurisdiction over Bedrosian’s claim under the Little Tucker Act (28 U.S.C. § 1346(a)(2)). To file a claim under the Little Tucker Act, Bedrosian made a partial payment of the FBAR penalty ($9,757,89) and the government counterclaimed for the full penalty amount. In a surprising decision, the Third Circuit determined that Bedrosian could not have brought his initial claim in the District Court under the Little Tucker Act because the FBAR penalty is assessed “under the internal-revenue laws” and, therefore, the refund claim should be brought under a tax refund statute contained in 28 U.S.C. § 1346(a)(1). Notably, tax refunds brought under this provision
are subject to the *Flora* rule, which requires a full payment of the penalty before the taxpayer has a right to seek a refund in a federal court. Because Bedrosian only made a partial payment of the penalty, the Third Circuit noted that it did not believe that Bedrosian had established jurisdiction to bring a refund claim in the District Court. Nevertheless, the court concluded that the government’s counterclaim for the remainder of the penalty “supplied jurisdiction under 28 U.S.C. § 1345,” and therefore it had appellate jurisdiction over the matter under 28 U.S.C. § 1291. In addition, the Third Circuit concluded that, even though the District Court’s jurisdiction was based in part on the Little Tucker Act, appellate jurisdiction was not exclusively vested in the Federal Circuit Court of Appeals because, notwithstanding it being a Title 31 provision, the FBAR statute was intended as part of the “IRS’s machinery for the collection of federal taxes,” and was thus an act “providing for internal revenue” for the purpose of 28 U.S.C. § 1295(a)(2).

Next, the court determined that the correct legal standard for determining “willfulness” encompasses both knowing and reckless violations. The court noted that, in connection with the IRS filings, a reckless violation occurs when the person, “(1) clearly ought to have known that (2) there was a grave risk that [the filing requirement was not being met] and if (3) he [or she] was in a position to find out for certain very easily.” (*quoting* U.S. v. Carrigan, 31 F.3d 130, 134 (3d Cir. 2012) (citation omitted)). Upon its review of the District Court’s record, the court concluded that the District Court may not have considered whether Bedrosian’s conduct met the objective recklessness standard. Accordingly, the Third Circuit remanded the case back to the District Court for further consideration.


The United States brought suit against Money and Nila Shinday, married taxpayers, to collect unpaid penalty assessments and interest. Nila Shinday was assessed non-willful FBAR penalties, totaling $10,000 per year, for tax years 2007 to 2011. Money Shinday was assessed willful FBAR penalties for the same tax years. The aggregate amount of the penalties were in excess of $250,000, which was divided equally between the five tax years.

Relying on *Colliot* and *Wahdan*, the defendants filed a motion to dismiss the complaint, arguing that the penalties exceeded the $100,000 penalty cap set by 31 C.F.R. § 1010.820(g)(2). Declining to address the validity of the regulatory penalty cap, the court denied the defendants’ motion to dismiss, finding that because each individual penalty was under $100,000 per year, it was within the bounds of the regulation.


In 2009, Alice Kimble applied to participate in OVDP to report her interest in the inherited foreign accounts. She later decided to opt out of the program. At the conclusion of the examination, the IRS determined that Kimble’s failure to file an FBAR for 2007 was “willful” and assessed a willful FBAR penalty of $697,229. Kimble paid the penalty and filed a refund suit in the Court of Federal Claims.

The government and plaintiff filed cross motions for summary judgement. The government argued that Kimble’s failure to file an FBAR, answer Question 7(a) on Schedule B,
and ask her accountant for advice constituted a reckless disregard of her statutory duty and therefore, her conduct was “willful.” Kimble argued that the higher penalty for willful violations was created to punish “bad” actors, which she was not, and that the penalty is capped at $100,000 under 31 C.F.R. § 1010.820(g)(2), consistent with the courts’ decisions in *Colliot* and *Wahdan*.

In a troubling decision, the Court of Federal Claims sided with the government on both points. On the question of willfulness, the court determined that the mere fact that Kimble did not review her tax returns for accuracy and checked the box “no” in response to Question 7(a) was sufficient to establish that she acted with a “reckless disregard” of her legal duty to report her offshore accounts. On the issue of the penalty cap, the court followed its prior decision in *Norman*, holding that the assessment was valid because the regulation was superseded by the American Jobs Creation Act of 2004, which increased the statutory penalty.


Steven Schoenfeld opened an account with UBS, Switzerland, in 1993 with proceeds from the sale of his New York apartment. In 2009, he was notified that UBS might share account information with the IRS, but Schoenfeld did not authorize UBS to share his information. In 2010, his UBS account was closed and the assets transferred to a U.S. brokerage firm.

In September 2014, the IRS assessed a willful FBAR penalty against Schoenfeld for failure to file the 2008 FBAR. The penalty remained unpaid. Unbeknownst to the government, Schoenfeld died in August of 2015. On September 29, 2016, the United States filed a complaint against Schoenfeld to reduce the penalty to judgment. On December 14, 2016, the government amended the complaint, naming the “Estate of Steven Schoenfeld and Robert Schoenfeld, a distributee of the Estate of Steven Schoenfeld,” as defendants. The amended complaint was filed after the applicable statute of limitations had expired. The defendants moved to dismiss the amended complaint, or in the alternative, grant their motion for summary judgement on the grounds that: (1) the original complaint was a legal nullity and cannot be cured by amendment; (2) the government may not rely on 28 U.S.C. § 2404 to pursue its claims and the Estate lacks capacity to be sued under FRCP 17; and (3) the government’s claim abated upon Schoenfeld’s death.

First, the court determined that, although the initial complaint was filed against a deceased individual, the lack of defendant’s capacity could be cured by amendment. Next, the court ruled that the amended complaint was not barred by the statute of limitations, because the original complaint had been timely filed, and the amended complaint related back to the original complaint in compliance with FRCP 15(c). Its determination was based on a finding that the government made a mistake concerning the identity of the proper defendant, as it believed he was still alive, and the proper defendant was on notice that it would be sued but for the mistake.

Second, the court considered the application of Section 2404 and the government’s ability to proceed against the Estate and its distributee under FRCP 17. The court ultimately dismissed the complaint against the Estate because, under FRCP 17 and Florida law, the Estate
could not be a party to the litigation—only the Estate’s personal representative, in that capacity, was the correct party. Because the amended complaint was filed against the Estate and not its personal representative, the court dismissed the complaint as against the Estate. The court also found that Section 2404 did not provide the means for the government to pursue the Estate because the statute addresses the continuation of the action where the defendant dies after the commencement of the suit. Nor was the Court convinced that the Estate could be pursued under equitable principles because the government did not provide any authority supporting the application of equitable principles to pursue a claim “in the absence of a legal basis and against a defendant which lacks the legal capacity to be sued.” Nevertheless, the court found that the government could pursue a claim against Robert Schoenfeld as the sole distribute of the Estate.

Finally, the court held that the government’s claim against Steven Schoenfeld survived his death, as it was “remedial in nature,” rather than “penal” under the Hudson analysis and Kennedy factors. Under the first step of the Hudson analysis, the court determined that Congress specifically indicated its view that the Section 5321 penalty was civil in nature because the statute was entitled “Civil Penalties” and conferred enforcement authority on the Secretary of Treasury. Under the second step of the Hudson analysis, the Court applied the seven Kennedy factors, finding that (1) a monetary fine did not involve “affirmative disability or retrain;” (2) monetary penalties have not historically been viewed as a punishment; (3) BSA authorized the Secretary to assess a penalty against all violators regardless of scienter, and scienter only affected the amount of the penalty; (4) although the FBAR penalties promote the traditional aims of punishment, retribution and deterrence, all civil penalties have some deterrent effect and none are “solely remedial;” (5) while the failure to file an FBAR can result in criminal prosecution, the fact that the criminal sanctions are contained in the separate statute “underscores” Congress’s intent to regard the civil penalty statute as remedial; (6) in addition to retribution and deterrence, the FBAR penalty served an additional purpose “as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer’s fraud;” and (7) the FBAR penalty was not excessive in relation to this alternative purpose.


In August 2015, Marsteller signed an agreement with the IRS, consenting to the assessment of $10,000 nonwillful FBAR penalties for each of the years 2008 through 2011. Marsteller failed to remit any payments to the IRS. On September 22, 2017, the United States filed an action to collect the civil penalties assessed against Marsteller. Marsteller failed to answer the complaint. The clerk filed an entry of default against Marsteller, who did not move to set aside the entry of default. The government moved for a default judgment and the District Court granted the motion.

**United States v. Garrity** No. 3:15-CV-243 (MPS) (District of Connecticut)

The IRS assessed a willful FBAR penalty against Paul Garrity and sued his estate in order to reduce the assessment to judgment. In June 2018, a jury found that the United States had established by a preponderance of the evidence that Garrity had a financial interest or authority over a foreign financial account and that he willfully failed to timely file a 2005 FBAR.
The jury also determined that the penalty was equal to or less than 50% of the balance in the account on June 30, 2006.