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FBAR Penalties Go to the Supreme Court: Dueling Statutory Interpretations

By
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For more than a decade, the government has pursued taxpayers who failed to report offshore accounts on Reports of Foreign Bank and Financial Accounts (FBARs). Practitioners representing clients caught in the government's crosshairs have raised a number of legal issues including whether the Required Records Doctrine precludes taxpayers from resisting subpoenas based on the Fifth Amendment privilege against self-incrimination (see Jeremy H. Temkin, *Second Circuit Tackles Required Records Exception*, N.Y.L.J. (Jan, 15, 2014)); the burden of proof and scienter standard to be applied when the Internal Revenue Service assesses civil willfulness penalties (see Jeremy H. Temkin, *Civil FBAR Penalty Litigation: No Reprieve for Taxpayers*, N.Y.L.J. (March 18, 2021)); and, most recently, the maximum penalty applicable when a taxpayer's FBAR violation was not willful (see Jeremy H. Temkin, *Non-Willful FBAR Penalties: A (Temporary) Reprieve for Taxpayers?*, N.Y.L.J. (May 19, 2021)). While the first issue raised significant constitutional questions and the second subjected taxpayers to potentially draconian financial penalties, the Supreme Court declined to weigh in on either point. See, e.g., *In re Special Feb. 2011-1 Grand Jury Subpoena Dated Sept. 12, 2011*, 691 F.3d 903 (7th Cir. 2012) (holding Required Records Doctrine precludes Fifth Amendment privilege), cert. denied 133 S. Ct. 2338 (2013); *U.S. v. Rum*, 995 F.3d 882 (11th Cir. 2021) (holding "willfulness" for FBAR civil penalties includes reckless disregard of a known or obvious risk), cert. denied, 142 S. Ct. 591 (2021).

Last month, however, the court agreed to resolve a split between the U.S. Courts of Appeals for the Fifth and Ninth Circuits over the correct interpretation of 31 U.S.C. §5321(a)(5)(A), which caps the civil penalty applicable to non-willful FBAR violations at $10,000. Specifically, the court granted a writ of certiorari in *Bittner v. United States* to consider whether the $10,000 cap on penalties for non-willful violations applies on a "per-account" basis (as the Fifth Circuit held in *U.S. v. Bittner*, 19 F.4th 734 (5th Cir. 2021)), or whether the penalty is capped at $10,000 for each year, regardless of the number of accounts involved (as the Ninth Circuit previously held in *U.S. v. Boyd*, 991 F.3d 1077 (9th Cir. 2021)).

'United States v. Boyd'

In *Boyd*, the taxpayer first disclosed her interest in several financial accounts located in the United Kingdom in connection with her participation in the IRS's 2012 Offshore Voluntary Disclosure Program. After Ms. Boyd opted out of that program's penalty structure, the IRS examined her tax returns and determined that she had "committed thirteen FBAR violations—one violation for each account she failed to timely report." While the IRS concluded that Boyd had acted non-willfully, i.e., that her failure to comply with the reporting obligation was "due to negligence, inadvertence, or mistake or con-

duct that [was] the result of a good faith misunderstanding of the requirements of the law," it nonetheless assessed $47,279 in penalties based on the size of the accounts in question. The district court upheld the assessment, agreeing with the government's contention that "multiple non-willful violations may spring from a single late but accurate FBAR, because 31 U.S.C. §5314 and its implementing regulations create reporting requirements that extend to each foreign account."

In a 2-1 decision, the Ninth Circuit court reversed. In particular, the Circuit Court relied on the implementing regulations defining the FBAR reporting requirements, noting that without the regulations "the [Bank Secrecy] Act [] would impose no penalties on anyone," as the Act requires a "violation of regulations promulgated by the Secretary [of the Treasury]" before any penalty can attach. On that basis, the court focused on the regulations' directives to use "*a reporting form*" to report foreign accounts, and to file the "*[t]he form*" timely, in finding that Boyd's only regulatory violation was missing the timely filing requirement, constituting a "single non-willful violation."

The Ninth Circuit rejected the government's reliance on 31 C.F.R. §1010.305(a), which defines the contents of the FBAR required under the statute, finding that the form that Boyd ultimately filed "was accurate," and disclosed all the information that was called for. The court also rejected the government's second argument, that use of the phrase "*any* violation" in §5321(a)(5)(A) means that multiple violations may occur in a single FBAR report under §5314(a), instead finding that phrase merely "refers to the relevant regulations that prescribe how … [§] 5314 may be violated," pursuant to which Boyd committed a single violation.

'United States v. Bittner'

While the amount at issue in *Boyd* boiled down to less than $40,000, the stakes for Alexandru Bittner were substantially higher as the IRS had assessed a total of $2.72 million in "non-willful" penalties on a taxpayer who failed to report a total of 272 accounts over the five years between 2007 and 2011. Much like the Ninth Circuit's later decision in *Boyd*, the district court relied on the Supreme Court's assertion that, absent implementing regulations, the Bank Secrecy Act of 1970 (the BSA) "would impose no penalties." See *California Bankers Ass'n v. Schulz*, 461 U.S. 21, 26 (1974). Thus, the court looked to the BSA's implementing regulations in concluding that Bittner had engaged in a single non-willful FBAR violation relating to his untimely filing of FBARs for each of the five years in question. As a result, the district court capped Bittner's penalty at $50,000.

A unanimous panel of the Fifth Circuit court reversed. Noting that "[p]roperly assessing the penalty [for non-willful violations under §5321(a)(5)] hinges on what constitutes a 'violation' of [§] 5314: the failure to file an FBAR … or the failure to report an account," the Circuit Court concluded that "each failure to report … constitutes a separate reporting violation subject to penalty. The penalty therefore applies on a per-account, not a per-form, basis." The Fifth Circuit rejected the district court's reliance on the implementing regulations, concluding that the "*Shultz* snippet does not help" because that case "did not interpret any penalty provision of the BSA," but was instead a constitutional challenge to the BSA, with the cited language forming part of the court's ripeness analysis. Accordingly, the Fifth Circuit began its analysis "with [§] 5314, not the regulations."

The Circuit Court then applied the statutory construction employed by the *Boyd* dissent, and found that §5314, and its implementing regulations, have "both a substantive and procedural element," namely—"the substantive obligation to file reports disclosing each [foreign] account" and "the procedural obligation to file the appropriate reporting form." Thus, by authorizing a penalty for "any violation of[] any provision of [§] 5314," §5321(a)(5)(A) "most naturally reads" as referring to violations of the substantive "requirement to report each account," rather than violations of the regulatory FBAR form requirements. The Fifth Circuit found further support for its position in other penalty provisions in §5321(a)(5), particularly §5321(a)(5)(C), which imposes a

maximum penalty for willful violations of "fifty percent of … 'the balance in the account at the time of the violation' (when a violation involves 'a failure to report the existence of an account.'" In doing so, the Fifth Circuit rejected the lower court's (and *Boyd*'s) view that Congress intended to create a different penalty regime when it added penalties for non-willful violations in the American Jobs Creation Act of 2004, and "purposely excluded the per-account language from the non-willful penalty provision."

'Bittner' and Beyond

Over the last several terms, the Supreme Court has received between roughly 5,200 and 6,600 applications to hear cases on the merits, but ultimately considered, at most, 86 such cases (with an acceptance rate ranging between 1% to 1.4%). See *The Statistics*, 135 Harv. L. Rev. 491, 498 (2021). Its decision to grant certiorari in *Bittner* may well have been driven by the fact that, if left unresolved, the split created by the appellate decisions in *Boyd* and *Bittner* would mean that a taxpayer in one of the nine states (and two territories) in Ninth Circuit's jurisdiction would face substantially lower penalties than a similarly situated taxpayer in one of the three states comprising the Fifth Circuit. Moreover, as the Fifth Circuit recognized, four other district courts have been confronted with this issue, and have likewise split over the penalty regime for non-willful FBAR violations, with district courts in New Jersey and Connecticut taking the per form approach and two district courts in the Southern District of Florida applying penalties on a per account basis. Compare *U.S. v. Giraldi*, No. 20-CV-2830 (SDW) (LDW), 2021 WL 1016215 (D.N.J. March 16, 2021) (taking per form view), and *U.S. v. Kaufman*, No. 18-CV-787 (KAD), 2021 WL 83478 (D. Conn. Jan. 11, 2021) (same), with *U.S. v. Solomon*, No. 20-CV-82236, 2021 WL 5001911 (S.D. Fla. Oct. 27, 2021) (taking per account view), and *U.S. v. Stromme*, No. 20-CV-24800 (UU) (S.D. Fla. Jan. 25, 2021) (same on default judgment); see also *U.S. v. Hadley,* No. 21-CV-1357 (AAS), 2022 WL 899701 (M.D. Fla. March 28, 2022) (applying per account view). The Second and Eleventh Circuits are holding the appeals in *Kaufman* and *Hadley* in abeyance pending the Supreme Court's decision in *Bittner*.

Moreover, as an ascendant majority of the Supreme Court leans hard into "textualism," the court may also have been enticed by the opportunity to consider the interpretation of a federal statute, and perhaps even to address what certain Justices have recently derided as statutory construction that "simply split[s] statutory phrases into their component words, look[s] up each in a dictionary, and then mechanically put[s] them together again," disregarding the "the linchpin of statutory interpretation …, *ordinary meaning*." *Bostock v. Clayton Cnty.,* 140 S. Ct. 1731, 1827-28 (2020) (Kavanaugh, J., dissenting) (internal quotations omitted) (emphasis in original); see id. at 1755-56 (Alito, J. and Thomas, J., dissenting).

On one hand, the court may be persuaded by the Fifth Circuit's approach, which eschews reference to the regulations in favor of focusing solely on the language enacted by Congress. On the other hand, that approach appears to be at odds with Congress's express statutory instruction that FBAR penalties are to be assessed in accordance with regulations that the "Secretary of the Treasury may impose." 31 U.S.C. §5321(a)(5)(A). In addition, although these cases do not directly implicate *Chevron* deference, *Bittner* may nonetheless offer some clues in the continuing debate over that doctrine, particularly given the current court's keen interest in the limits of regulatory authority, see, e.g., *West Virginia v. E.P.A.*, 142 S. Ct. 2587 (2022), and the relevance of the IRS's position on the meaning of the penalty regime it is tasked with administering. The outcome of *Bittner v. United States* will undoubtedly have immediate implications for the tax bar, and may well have even more far-reaching ramifications.

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