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Alert | Tax Controversy and Litigation

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Non-Willful Failure to File FBAR Under BSA Should Be Penalized on a Per-Report Basis, Supreme Court Rules for Taxpayer Against IRS

Go-To Guide:

- Supreme Court holds that non-willful FBAR penalty applies on a per-form, not per-account, basis
- IRS past public position counts – even if IRS changes its mind in current litigation
- New rule only applies to "non-willful" failures to file, not "willful" failures

The applicable penalty for the non-willful failure to file a foreign financial account is applied on a per-form basis, not a per-account basis, the U.S. Supreme Court decided Feb. 28 in *Bittner v. United States*. This ruling, a divided opinion, settles a split among the circuit courts, provides significant relief to taxpayers who have failed to file (or late-filed) a form to report interests in foreign financial accounts when that failure is not willful. The opinion is important for two other reasons. First, it provides helpful analysis for taxpayers as they face off against the Internal Revenue Service. Second, it serves as a reminder that the real fight is about willfulness, as the new "one form" rule does not apply to willful failures.

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Background

Generally, the Bank Secrecy Act (BSA) requires U.S. persons to file with the U.S. Department of Treasury a single annual report listing any foreign financial accounts in which the U.S. person has an interest or authority over – where the combined value of all foreign accounts exceeds $10,000 during the calendar year. These forms, colloquially referred to as FBARs (Report of Foreign Bank and Financial Accounts), must be filed by the same due date as the U.S. person's personal income tax return.

Failure to file or late-filing of an FBAR exposes a U.S. person to both civil and criminal penalties. The civil penalty aspect of the statute was at issue in *Bittner*. More specifically, in *Bittner*, the U.S. person filed an FBAR but failed to report all of his foreign bank accounts. The IRS determined that Bittner's conduct was "non-willful" (i.e., not intentional or knowing, but more of a mistake) and assessed a penalty equal to $10,000 per unlisted account. Because there were multiple unlisted accounts, the aggregate non-willful penalty equaled $2.72 million for the years 2007 through 2011. Bittner challenged the IRS assessment, claiming that the penalty should only be assessed per form – not per account – and that the applicable penalty was less than $100,000. Ultimately, Bittner lost in the district court, which assessed the IRS's requested $2.7 million penalty.

Bittner appealed to the Fifth Circuit, which agreed with the IRS. Meanwhile, in a similar case, the Ninth Circuit reached the opposite conclusion that the IRS could only assess one $10,000 penalty per year for a non-willful failure to file an FBAR. After losing in the Fifth Circuit, Bittner sought, and was granted, certiorari in the Supreme Court.

Supreme Court Holding in *Bittner*

On Feb. 28, the majority of the Supreme Court agreed with Bittner's position, holding that the "BSA treats the failure to file a legally compliant report as one violation carrying a maximum penalty of $10,000, not a cascade of such penalties calculated on a per-account basis." The Court's holding was based on multiple grounds:

- According to the Court, the statutory language in 31 U.S.C. § 5314 and 5321 does not support the IRS's position. Whereas Congress specifically authorized the IRS to impose the willful FBAR penalty on a per-account basis, the statute does not include similar language with respect to non-willful penalties. Applying the principles of statutory construction, the Court concluded that Congress did not intend for non-willful penalties to apply on a per-account basis.
- The Court cited to the IRS's own public guidance suggesting that failure to file an FBAR may result in a penalty *not to exceed $10,000*. The public guidance included a notice of proposed rulemaking issued by the Department of Treasury, the instructions to the old FBAR form (i.e., TDF 90-22.1), and a letter issued to the taxpayer. Although the Court was not bound by the IRS's published guidance, it concluded that the IRS's prior inconsistent interpretation of 31 U.S.C. § 5321(a)(5) undermined its current litigating position.
- The Court examined the legislative history of the statute and determined that the purpose of the FBAR requirement was to put the government on notice that further investigation may be necessary, not to maximize revenues for each mistake.
- The Court noted that the government's interpretation of the statute could produce irrational results. For example, a taxpayer who non-willfully failed to report a single account with a $10 million balance would only be subject to a penalty of $10,000, whereas a taxpayer who non-willfully failed to report 12 foreign accounts with an aggregate balance of $10,001 would be subject to a penalty of $120,000.

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- Finally, the Court concluded that penal statutes should be construed strictly. According to the Court, an individual should not be subject to a penalty unless the language of the statute plainly mandates that a penalty should apply. Here, the government's interpretation would create a fair notice problem under the Due Process Clause because the statute does not discuss per-account penalties for non-willful violations.

Conclusion

The Court's holding in *Bittner* is a welcome result for U.S. persons who have failed to file (or late-filed) FBARs and significantly reduces exposure in non-willful cases. *Bittner* has two other important takeaways. First, the case demonstrates that the Court will weigh the IRS's prior public guidance on an issue heavily in evaluating the IRS's interpretation of a statute. If the IRS has taken a public position, that position counts – even if the IRS changes its mind. Second, and perhaps most importantly, this new rule only applies to "non-willful" failures to file, not "willful" failures. Under current case law, the term "willful" has been construed to mean a knowing or reckless failure to file an FBAR. If the IRS determines that a taxpayer willfully failed to file an FBAR, then the one-form rule does not apply and the IRS can assess penalties by account, up to and including 50% of the highest account value. These controversies – and developing admissible persuasive evidence of non-willfulness – require the hiring of experienced, knowledgeable tax controversy counsel.

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