

Taxes, the Fifth Amendment, And Foreign Accounts

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In this article, Wood and Weese discuss *Youssefzadeh*, in which the Tax Court suggested that some Fifth Amendment tax return claims might pass muster for at least some purposes, and they examine the decision's larger implications under the required records doctrine authorities.

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Anyone who has watched a crime drama knows about taking the Fifth.¹ The hard-nosed prosecutor asks the accused if he did it. The courtroom hushes, just for a second. Then: "I refuse to answer on the grounds that I may incriminate myself." TV prosecutors seem to hate that answer. So does the IRS.

The IRS hears many frivolous arguments and spends considerable resources knocking them down. It even publishes and updates a list of its least favorites, along with helpful citations to all the authorities explaining why they fail.² Being accused of frivolity is no laughing matter in the tax world.

Section 6702 imposes a \$5,000 penalty for taking a frivolous position on a tax return. The penalty can also apply to some stand-alone forms and various procedural submissions.

To the IRS, pleading the Fifth is a frivolous argument. Way back in 1927, no less than Supreme Court Justice Oliver Wendell Holmes Jr. derided this supposed magic trick when a taxpayer with illegal-source income failed to file a tax return, claiming that filing a return would incriminate him.³ With typical flair, Holmes wrote: "He could not draw a conjurer's circle around the whole matter by his declaration that to write any word upon the government blank would bring him into danger in the law."⁴

So it was no surprise to hear that in a recent Tax Court case, *Youssefzadeh v. Commissioner*,⁵ the IRS was aggressively imposing the section 6702 frivolous return position penalty when a taxpayer pleaded the Fifth Amendment. *Youssefzadeh* involved foreign bank accounts and an attempt to keep information about them out of the government's hands. The case also offers useful guidance about how to (and mostly how *not* to) claim the Fifth Amendment directly on a tax return.

But other cases invoking an old doctrine called the required records doctrine (also called the required records exception) suggest that taking the Fifth may be counterproductive if the government already has reason to believe you have foreign accounts. Even if you can avoid being penalized for not reporting them on your tax returns, taxpayers with unreported foreign accounts are best advised to disclose them.

FBARs and the Frivolous Return Penalty

A U.S. person with more than \$10,000 overseas must file an annual report of foreign bank accounts. The foreign bank account report, previously Form TD F 90-22.1, is now Financial Crimes Enforcement Network Form 114.⁶ The deadline to file FBARs used to be June 30 each year, and it could not be

³*United States v. Sullivan*, 274 U.S. 259 (1927).

⁴*Id.* at 264.

⁵*Youssefzadeh v. Commissioner*, No. 14868-14 (Nov. 6, 2015).

⁶31 U.S.C. section 5314; Treasury Circular 230, 31 CFR section 1010.350.

¹U.S. Constitution, Amendment V.

²IRS, "The Truth About Frivolous Tax Arguments" (Jan. 2015).

extended. Congress recently moved the filing date to April 15 and has allowed for extensions.⁷

Willful failure to file an FBAR is a criminal offense.⁸ The monetary penalties and jail time for FBAR crimes are far larger and longer than for tax evasion. And FBAR crimes are generally easier for the government to prove than tax evasion. Even the civil fines for FBAR failures are enormous, reaching up to 100 percent of the accounts value in some egregious circumstances.⁹

Youssef Youssefzadeh was apparently aware of how seriously the government takes FBAR reporting. He wisely did not lie, which is an entirely separate crime.¹⁰ Instead, he completed his 2011 tax return, including a Schedule B, dutifully reporting all interest income he received during the year.

Rather than listing each bank — and possibly admitting that some of his interest income came from offshore banks — Youssefzadeh omitted some of the bank *names* from Schedule B. On Part III, line 7 of the Schedule B, he refused to answer whether he was required to file an FBAR. Instead, he asserted his Fifth Amendment right.

The IRS was not amused and threatened the section 6702 frivolous return position penalty. Youssefzadeh refused to budge, so the IRS imposed the penalty and initiated collection procedures. Youssefzadeh filed a timely request for a collection due process hearing to challenge the underlying liability. In it, he argued that his Fifth Amendment claim was valid and not frivolous.

The IRS Appeals officer upheld the penalty, and the case advanced to Tax Court. The Tax Court reviewed the requirements of the frivolous position penalty. First, the document containing the allegedly frivolous position must purport to be a tax return. Here, that was clear: The filing was on a standard tax return form and had all the information needed to calculate tax.

Second, the return must omit enough information to prevent the IRS from judging the substantial correctness of the return. Alternatively, the position must clearly be substantially incorrect. The court noted that this factor requires that the return be merely “substantially correct,” rather than “completely correct.” The court found that Youssefzadeh’s tax return was substantially complete

precisely because the proper numerical information (the interest income) was present.

Finally, for the IRS to win on the penalty, the position itself must be frivolous or reflect a desire to impede administration of the tax code. Baseless positions, and positions on the IRS’s naughty list, will usually satisfy this high hurdle. One of those naughty list items is asserting the Fifth Amendment.

With all this, you might fairly assume that the IRS would win and Youssefzadeh would lose. Yet, at least on this small issue, he triumphed. How? Because his assertion was *specific, limited, and reasonably related to a criminal concern*. It was not a blanket objection to providing information.

Blanket Versus Specific

Youssefzadeh highlights an interesting nuance between frivolous blanket assertions and substantially correct assertions, which can squeak past a penalty. A blanket assertion of the Fifth Amendment on a tax return is analogous to a recalcitrant witness who refuses to answer any question at all. In a courtroom, you may be able to refuse to answer any questions.

But on a tax return, you are legally required to give the IRS enough information to calculate your taxes. The typical Fifth Amendment return contains no or very limited information and fails to meet that basic legal requirement. IRS agents are prepared for these kinds of returns, and they have plenty of authority to back up the hard party line.¹¹

The Tax Court distinguished Youssefzadeh’s tactic from faulty blanket assertions: “The face of Youssefzadeh’s return includes all of a normal return’s numerical information — he’s not one of those tax protesters who fills out a return with zeroes on nearly every line.”¹² It was exactly because he provided the information necessary to fully report his income and calculate his tax liability that his Fifth Amendment right was in play.

One can certainly add to the mix the reasonableness of Youssefzadeh’s fear that providing the relevant information could be evidence that he violated a specific criminal statute. His claim was hardly frivolous. Of course, emulating Youssefzadeh scarcely seems like a good idea.

First, the case itself cannot be cited as precedent. It is an order under Tax Court Rule 50(f), rather than an opinion of the court. Second, the section 6702 penalty is relatively small, and beating it should not

⁷H.R. 3236, Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, P.L. 114-41, section 2006(b)(11) (effective for tax years beginning after December 31, 2015).

⁸31 U.S.C. section 5322.

⁹IRS, “Interim Guidance for Report of Foreign Bank and Financial Accounts (FBAR) Penalties,” SBSE-04-0515-0025 (May 13, 2015).

¹⁰Section 7206.

¹¹See Internal Revenue Manual sections 4.10.12.1.2(6) and 4.10.12.1.1(J); *Sullivan*, 274 U.S. 259; *United States v. Irwin*, 561 F.2d 198 (10th Cir. 1977); *United States v. Neff*, 615 F.2d 1235 (9th Cir. 1980).

¹²*Youssefzadeh*, No. 14868-14, at 3.

be anyone's priority. Third, and perhaps most important, Youssefzadeh surely signaled to the government that he was supposed to file an FBAR and intentionally failed to do it — also known as willful conduct. That is vastly more serious.

In fact, it may be a little like an accused murderer quickly fleeing a crime scene, fighting hard to avoid a speeding ticket. With all these caveats, however, *Youssefzadeh* still provides useful guideposts. Could there occasionally be some conceivable context in which it might somehow be legitimate to assert a Fifth Amendment right directly on a tax return? Perhaps, but it is striking just how limited the Fifth Amendment's protections can be for offshore accounts.

Required Records Doctrine

FBARs are not tax forms. But, as most people now recognize, they have big tax implications, particularly as the Foreign Account Tax Compliance Act picks up steam. You can run afoul of FATCA with your taxes in several ways. Some examples include failure to file an FBAR;¹³ Form 5471, "Information Return of U.S. Persons With Respect to Certain Foreign Corporations";¹⁴ Form 8865, "Return of U.S. Persons With Respect to Certain Foreign Partnerships";¹⁵ Form 8938, "Statement of Specified Foreign Financial Assets";¹⁶ Form 3520-A, "Annual Information Return of Foreign Trust With a U.S. Owner";¹⁷ or Form 8621, "Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund."¹⁸

These failures and others can all lead to nasty penalties. Notably, the failure to file some international information returns can keep the statute of limitations open indefinitely.¹⁹ What's more, the statute remains open not merely for the foreign items, but for the entire tax return — forever.

Of course, the offshore voluntary disclosure program exists to allow people to fix these problems. Yet the program is getting harsher as more and more banks reach agreements to turn over client names.²⁰ Outside the OVDP and the related streamlined programs, taxpayers face serious financial and

criminal risks. Those risks were surely what Youssefzadeh was trying to avoid.

The government may find you before you have the chance to come clean. If it does, it can subpoena your offshore account records. In these cases, you may think that you could assert a solid Fifth Amendment claim just like the accused on the witness stand. After all, it was reasonable for Youssefzadeh to take the Fifth when all the government wanted was information *about* the banks.

But as it turns out, pleading the Fifth in response to a subpoena for foreign account records causes even more trouble than claiming the Fifth on your tax returns. The reason is the required records exception to the Fifth Amendment, which dates back to a 1948 Supreme Court decision, *Shapiro v. United States*.²¹ In *Shapiro*, the Supreme Court drew a distinction between "private papers" and "required records," which must be maintained by law.

Private papers are personal records and are protected by the Fifth Amendment. Required records, however, are apparently not protected by the Fifth Amendment.²² A record is "required" if it meets a three-pronged test: (1) the reporting or record-keeping scheme must have an essentially regulatory purpose; (2) a person must customarily keep the records that the scheme requires him to keep; and (3) the records must have "public aspects."²³

The basic idea is that the government legally requires you to keep specific records if you want to engage in particular activities, so you have to keep them anyway.²⁴ In fact, the government has some legitimate right to inspect those papers to make sure you're complying with a government program. In that sense, these required records are not fully "your" records.

At least, that's how the argument goes. And for the government, it has been a good — one might even say a devastatingly effective — argument. So far, seven circuits have applied the required records doctrine to cases involving foreign account records. In the Second,²⁵ Third,²⁶ Fourth,²⁷ Fifth,²⁸

¹³31 U.S.C. section 5321.

¹⁴Section 6038.

¹⁵*Id.*

¹⁶Section 6038D.

¹⁷Section 6048(b).

¹⁸Section 1298(f).

¹⁹See section 6501(c)(8)(A).

²⁰As of December 28, 89 banks have reached agreements with the U.S. government and have been added to the OVDP "bad banks" list, available at <https://www.irs.gov/Businesses/International-Businesses/Foreign-Financial-Institutions-or-Facilitators>. If you enter the OVDP after a bank has been added to the list, the OVDP penalty increases from 27.5 to 50 percent. IRS,

(Footnote continued in next column.)

"Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers," FAQ 7.2 (June 2014) (OVDP FAQs).

²¹335 U.S. 1 (1948).

²²*Id.* at 33-34.

²³*Grosso v. United States*, 390 U.S. 62, 67-68 (1968).

²⁴This is not so different in concept than Congress's insistence that you keep specific records if you want to claim meals and entertainment expenses. See section 274.

²⁵*In re Grand Jury Subpoena Dated February 2, 2012*, 741 F.3d 339 (2d Cir. 2013).

²⁶*United States v. Chabot*, 793 F.3d 338 (3d Cir. 2015), cert. denied, Nov. 30, 2015 (Sup. Ct. Dkt. No. 15-503).

²⁷*United States v. Under Seal*, 737 F.3d 330 (4th Cir. 2013).

²⁸*In re Grand Jury Subpoena*, 696 F.3d 428 (5th Cir. 2012).

Seventh,²⁹ Ninth,³⁰ and Eleventh circuits,³¹ individuals tried to argue that handing over their foreign account records, or even admitting those records exist, would provide the government incriminating evidence shielded by the Fifth Amendment.

In each of those circuits, the government has been able to defeat the privilege. As recently as November 30, 2015, the Supreme Court has been unwilling to take up a case to revisit the required records doctrine.³² This is so despite an eloquent 2013 attempt in which a former solicitor general, Paul Clement, wrote:

The government's brief in opposition proceeds as if *Shapiro v. United States*, 335 U.S. 1 (1948), were a bedrock of this Court's modern Fifth Amendment jurisprudence. Nothing could be further from the truth. *Shapiro* is an anachronism. The Court's more recent act-of-production cases have eviscerated the doctrinal underpinnings of *Shapiro* and rendered the required records doctrine functionally obsolete. Commentators recognized *Shapiro's* obsolescence decades ago, *see, e.g.*, Samuel A. Alito, Jr., "Documents and the Privilege Against Self-Incrimination," 48 *U. Pitt. L. Rev.* 27 (1986), and for years prosecutors resisted the temptation to breathe new life into a moribund doctrine. No longer. In a spate of recent prosecutions, the government has combined *Shapiro* and the Bank Secrecy Act to compel individuals to prove the government's case through the act of production. That truly offends bedrock principles of the Court's modern Fifth Amendment jurisprudence.³³

Nevertheless, the required records doctrine persists, and there is no sign that the other circuits or the Supreme Court will change it. Which brings us back to Youssefzadeh, or at least to people in similar circumstances.

Disclosure

Despite Lois Lerner's famous connection with the IRS and with asserting the Fifth, the Fifth Amendment offers little protection in the tax realm. Merely invoking it invites penalties and can be enough to get the IRS looking at you. Harshly. But

²⁹*In re Special February 2011-1 Grand Jury Subpoena Dated September 12, 2011*, 691 F.3d 903 (7th Cir. 2012).

³⁰*In re M.H.*, 648 F.3d 1067 (9th Cir. 2011).

³¹*In re Grand Jury Proceedings*, 707 F.3d 1262 (11th Cir. 2013).

³²*Chabot*, 793 F.3d 338, *cert. denied*, Sup. Ct. Dkt. No. 15-503.

³³Reply Brief for Petitioner at 1, *In re Special February 2011-1 Grand Jury Subpoena Dated September 12, 2011*, Sup. Ct. Dkt. No. 12-853.

if you must, remember (à la Holmes) that it is more of a card trick than a conjurer's circle.

Youssefzadeh makes it clear that you still have to give the IRS all the information necessary to calculate your taxes. That means every penny of offshore income must show up on your return. Still, being less than 100 percent candid means you are throwing up a red flag about potential foreign accounts, which the U.S. government can track down in other ways.

In seven circuits, the government can compel you to hand over financial records that prove you have the accounts. Unless the Supreme Court eventually says otherwise, it doesn't matter that handing over the records is incriminating. It means, as thousands of advisers have said to tens of thousands of clients, disclose the accounts and pay whatever it takes.

The OVDP is more expensive but more certain than the streamlined programs. The OVDP involves eight years of tax returns, FBARs, bank records, back taxes, interest, and penalties. For many clients, the most difficult part is the 27.5 percent penalty on their highest aggregate account balance over those eight years.

Indeed, this 27.5 percent account balance penalty can now climb to 50 percent if you banked with the wrong institution or if the government already has your name.³⁴ But it doesn't have to be that bad: If you can establish that you are non-willful, you may qualify for a much more forgiving 5 percent (or even 0 percent) penalty under one of the streamlined programs, although these lack the formality of the closing agreement that you can get in the OVDP.

Conclusion?

Many taxpayers today are still facing uneasy questions about filing strange forms for the first time. Many worry about reporting accounts that may have an unclear or troublesome provenance. Many wonder who must report a joint account, particularly when it isn't crystal clear which of the nominal co-owners owns which portion of the account.³⁵

In that sense, *Youssefzadeh* is an unfortunate case. It may suggest to taxpayers that Fifth Amendment claims are a good idea or that they may be an alternative to disclosure. Even for taxpayers who think they can't use any of the disclosure programs, there is usually a way to disclose. Fighting about records and reporting usually means losing, one way or another.

³⁴OVDP FAQs, *supra* note 20, at FAQs 7 and 7.2.

³⁵For further discussion of joint accounts, see Robert W. Wood, "Taxes and FBARs for Joint Bank Accounts," *Tax Notes*, Oct. 19, 2015, p. 441.