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Court Upholds Record FBAR Penalties, Exceeding Offshore Account Balance

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Tax lawyers have been watching the case of Mr. Carl R. Zwerner of Coral Gables, Florida, wondering how it might impact others with foreign accounts. But now, the IRS and Justice Department seem to be smiling after chalking up another big victory in the fight over offshore accounts. Tax advisers are less happy, and Mr. Zwerner is almost certainly disappointed.

U.S. persons must report their worldwide income on their taxes. Plus, they must file an FBAR annually if their offshore accounts total over $10,000 at any time. If you have both failures, the IRS wants you to go into the Offshore Voluntary Disclosure Program, also known as the OVDP. It involves reopening eight tax years, and paying taxes, interest and penalties, but no prosecution.

But the penalties can be painful, especially the one equal to 27.5% of the highest balance in the offshore accounts. As a result, some people want to amend their taxes and file FBARs *outside* the OVDP. Some people are willing to pay the taxes they owe, but not the 27.5% penalty. The IRS calls this a "quiet disclosure" and says it will come after you if you try it.

That might include prosecution or large civil FBAR penalties. That's where Mr. Zwerner comes in. His facts are complex, and he tried to come forward in 2009 even before the IRS had a special program. You'd think that might immunize him, but it didn't.

The IRS went after Mr. Zwerner for $3,488,609.33 in penalties for FBAR violations. How did it get to that huge number? It's 50% of the highest balance in the account each year. Mr. Zwerner fought the penalty in court, but a jury has upheld the IRS. The jury found Mr. Zwerner willful for 2004, 2005 and 2006, but not for 2007. *See* . Florida Man Penalized Record 150% for Swiss Account.

That meant FBAR penalties of $2,241,809 for an account worth $1,691,054, less than the penalties. What was considered willful? Mr. Zwerner kept the accounts under two different entity names, and his tax return said "No" he didn't have any foreign accounts. Still, there were some sympathetic facts here.

Mr. Zwerner is 87 years old. He had his tax counsel in 2008 contact IRS Criminal Investigation and make a voluntary disclosure. Mr. Zwerner disclosed the existence of his offshore account (including income generated by the account) on his timely filed 2007 tax return and paid the taxes.

But it was not done perfectly. His former tax lawyer asked the IRS anonymously, so in IRS parlance, Mr. Zwerner didn't fully come forward. Still, he did file amended returns for 2004, 2005 and 2006 and FBARs. But in 2010, the IRS began an audit.

It didn't go well, and the IRS pushed hard. In fact, it was going so badly that Mr. Zwerner tried to join the 2011 IRS program called the OVDI. However, the IRS refused to allow him to participate because he was under audit. These are unusual facts, but should have helped Mr. Zwerner, not hurt him.

Remember, the government carries the burden of proving willfulness. Yet there may be little sympathy for someone with large financial resources who fails to inquire about reporting requirements. Plus, willfulness can include conscious efforts to *avoid* learning about the FBAR reporting. It is sometimes called *willful blindness*.

Are these penalties excessive? Some say they are, and this legal question may now be squarely raised. The court is expected to address that next, even considering whether such penalties could be unconstitutional. The Excessive Fines Clause of the Eighth Amendment suggests that a civil penalty may be unconstitutional if it is part punishment, and if the punishment is grossly disproportionate to the conduct.

Are these penalties way out of proportion? We'll see. In the meantime, the IRS OVDP probably looks even more attractive than it did. Sure, a 27.5% penalty is high. But it is a lot better than paying a penalty exceeding 100% of the account balance.

For more information, in the Tax Management Portfolios, see Blum, Canale, Hester, and O'Connor, 947 T.M., Reporting Requirements Under the Code for International Transactions, and in Tax Practice Series, see ¶7170, U.S. International Withholding and Reporting Requirements and FATCA.

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