Constructive Knowledge Not Enough for FBAR Willfulness

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Body

by Andrew Velarde

A district court has bucked the trend of other courts andrejected ***constructive knowledge*** as sufficient to support the contentionthat a taxpayer's conduct was willful when failing to file foreignbank account reports.

On August 22, in an order denying the government'smotion for summary judgment in *United States v. Flume*,No. 5:16-cv-73 (2018-34312) (S.D. Texas 2018),the U.S. District Court for the Southern District of Texas notedthat although there was some evidence that Edward S. Flume Jr. triedto hide his Swiss account, there were ***enough*** facts in dispute aboutFlume's conduct that a reasonable fact finder could conclude thatthe taxpayer neither knowingly nor recklessly failed to file FBARs.While several other courts have weighed in on the matter of whatconstitutes ***willfulness***, it was an issue of first impression withinthe Fifth Circuit, the court noted.

The distinction betweena willful failure to file FBARs and a non-willful violation canbe significant, with the former carrying penalties of the greaterof $ 100,000 or 50 percent of the account balance and the latterresulting in penalties of up to $ 10,000.

Flume, a U.S. citizenliving in Mexico, had signed his tax returns prepared by his return preparerfor 2007 and 2008. The returns indicated that Flume had foreignaccounts, but only disclosed Mexico as the country where they were held- omitting Switzerland, where Flume also had an account with UBS.He did ***not*** timely file FBARs for either year at issue and insteadfiled overdue FBARs in 2010. The IRS assessed penalties of nearly$ 500,000 for a willful

failure to file FBARs. While Flume's returnpreparer claimed he told the taxpayer about the duty to file FBARsas far back as 2003 or 2004, Flume claimed he did ***not*** learn of suchduty until 2010.

The government contended that Flume's own self-servingtestimony could ***not*** defeat summary judgment. But Judge Diana Saldañawas unconvinced, finding self-serving testimony still created agenuine dispute about ***knowledge*** of ***FBAR*** filing. Further, other evidenceexisted to dispute Flume's actual ***knowledge***, including his filingof overdue FBARs in 2010.

"Finding ***willfulness*** even wherethe defendant acted promptly to rectify his error would create aperverse incentive. It would encourage taxpayers who have ***not*** filedFBARs on time to never file them at all in the hope that the IRSdoes ***not*** discover their foreign accounts," Saldaña said in a footnotein the order.

More Than a Signature Needed

While acknowledgingthe decisions in two of the most prominent cases to weigh in on ***willfulness***- *United States v. Williams*, 489Fed. Appx. 655 (Doc 2012-15503) (4th Cir. 2012), and *United States v. McBride*, No. 2:09-CV-00378 (Doc 2012-23144) (D. Utah 2012)- the district court found those other courts' rationale that taxpayershave ***constructive knowledge*** of the contents of their returns bysigning them incorrect. It further rejected the theory that taxpayersare on "inquiry notice" of ***FBAR*** requirements because of ScheduleB's directions to look to instructions of ***FBAR*** requirements.

Theconstructive ***knowledge*** theory would ignore a distinction Congressdrew between willful and non-willful violations, Saldaña said, addingthat if a mere return signature led to a presumption of knowledgeof ***FBAR*** filing requirements, it would be hard to determine that anyviolations were non-willful.

Saldaña noted that the courtwould be exceeding its summary judgment authority if it presumedFlume examined his returns simply because he signed them under penaltiesof perjury, since he later testified - also under penalties of perjury- that he did ***not*** know about the ***FBAR*** requirement. Further, thecourt held that the theory was based on "faulty policy arguments"and to hold otherwise would encourage taxpayers ***not*** to read theirreturns, since taxpayers still face penalties of up to $ 10,000 fornon-willful violations and could also be found willful through recklessness.

Practitionershave previously criticized court holdings that would impose willfulnesspenalties on taxpayers based on as little evidence as the instructionsfor line 7a of Schedule B from Form 1040 putting a taxpayer on noticeof ***FBAR*** requirements, even absent a showing of improper motive.Some concerned practitioners have likened it to de factostrict liability (2017-70804). Thus, it was no surprise that practitionerswelcomed the *Flume* order.

"The court, in refusingto follow the *Williams* and *McBride* courts' constructiveknowledge theory, correctly points out that its application wouldrender the distinction between willful and non-willful ***FBAR*** violationscompletely meaningless," Josh O. Ungerman of Meadows, Collier, Reed,Cousins, Crouch & Ungerman LLP said.

Zhanna A. Zieringof Caplin& Drysdale Chtd. also received *Flume*'sdeparture from recent ***FBAR*** jurisprudence on ***constructive knowledge*** positively.

"Theview that a signature on the tax return presumes ***knowledge*** of theFBAR requirements is troubling as it seems to eliminate the statutory knowledgeprong," Ziering said.

Looking to *Bedrosian*

Thegovernment asserted that even failing a showing of actual or constructiveknowledge, Flume acted recklessly. But the district court lookedto *Bedrosian v. United States*, No.2:15-cv-05853 (2017-70627) (E.D. Pa. 2017), the case with arguably the mostsimilar facts as *Flume*, as instructive in setting a highbar for recklessness.

In *Bedrosian*, currently on appeal (2017-96840) in the Third Circuit,the U.S. District Court for the Eastern District of Pennsylvaniafound the government failed to prove that a pharmaceutical executive hadwillfully failed to list one of his two Swiss bank accounts at UBS,finding he was at most negligent and ***not*** reckless.

The courtin *Flume* disagreed with the government's assertions thatthe taxpayer must have known there was a risk he was violating the lawbecause of steps he took to conceal the account, evidenced in partby a UBS account executive's written summary of a meeting with Flumestating that the taxpayer's main preoccupation was with the IRS'sinvestigations of UBS.

Ungerman found the court's referenceto the banker's summary notes of the conversation interesting, giventhat many UBS cases include banker notes never presented to or reviewedby the taxpayer.

The court also countered the government's contentionthat there was no genuine dispute over recklessness since Flumeadmitted that he didn't bother to consult ***FBAR*** instructions. Flume'suse of a return preparer meant it was arguably ***not*** reckless forhim ***not*** to read the instructions, having relied on his preparer'sexpertise, the court reasoned.

Ziering found the districtcourt's willingness to follow *Bedrosian* encouraging.

"Theline between recklessness and negligence in the context of FBARviolations is indistinct and fluid at times," Ziering said. "We arein dire need of judicial guidance on where negligence ends and recklessnessbegins."

References

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