

## **Advanced Strategies for Challenging FBAR Penalties: Using Administrative Procedures Act In Defending Against Assessments**

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1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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# PART ONE

## Significance of the FBAR Penalties

# FBAR Requirements

- Overview of FBAR requirements
  - The rules governing FBAR filing and FBAR penalties are codified in Title 31 (Money and Finance) of the U.S. Code.
- Who has legal obligation to file an FBAR defined
  - A “US Person”;
  - Had a “financial interest” in, or “signature authority” over, or “other authority” over;
  - One or more “financial accounts”;
  - Located in a “foreign country”;
  - Aggregate value of such amount(s) exceeded \$10,000;
  - At any time during the calendar year.

# Onerous Penalties for Failure to File

## Willful Penalties

- The penalty is the greater of \$100,000 or 50 percent of the balance in the account at the time of the violation.
  - The Supreme Court explained that “willfully” is a word of many meanings, whose construction has many meanings, and whose construction is often dependent on the context in which it applies. Safeco Ins. Co. of America v. Burr, 551 U.S. 47 (2007).
- The IRS always has the burden to prove the willful failure to report foreign assets. U.S. v. McBride, 908 F.Supp.2d 1186, 1202 (D. Utah 2012).
  - This burden applies not only in litigation, but also in administrative proceedings. I.R.M. 4.26.16.6.5.1.3 (Nov. 6, 2015).

## Non-willful Penalties

- Shall not exceed \$10,000 per violation. 31 U.S.C. Section 5321(a)(5)(B)(i).
- 31 U.S.C. Section 5321(a)(5)(B)(ii) states that no penalty shall be imposed if “such violation was due to reasonable cause” and “the amount of the transaction or the balance in the account at the time of the transaction was properly reported.”
- “Reasonable Cause” is not defined in the Bank Secrecy Act or its regulations. It appears the definition of reasonable cause is similar to 26 U.S.C. Section 6664(c)(1).

# Collection of FBAR Penalty Assessment

- Since FBAR penalties are imposed under Title 31 of the U.S. Code and not the Internal Revenue Code, the assessment and collection procedures are different than for Title 26 tax penalties.
- Statute of limitations to assess an FBAR penalty and liquidate into a judgment
  - Civil statute of limitations
    - **6 years** from date of violation
  - Department of Justice (DOJ)
    - **2 years** to sue to reduce to judgment from the later of:
      - Assessment date of IRS FBAR penalty **OR**
      - Date any judgment becomes final in criminal action involving the same transaction that resulted in the penalty.

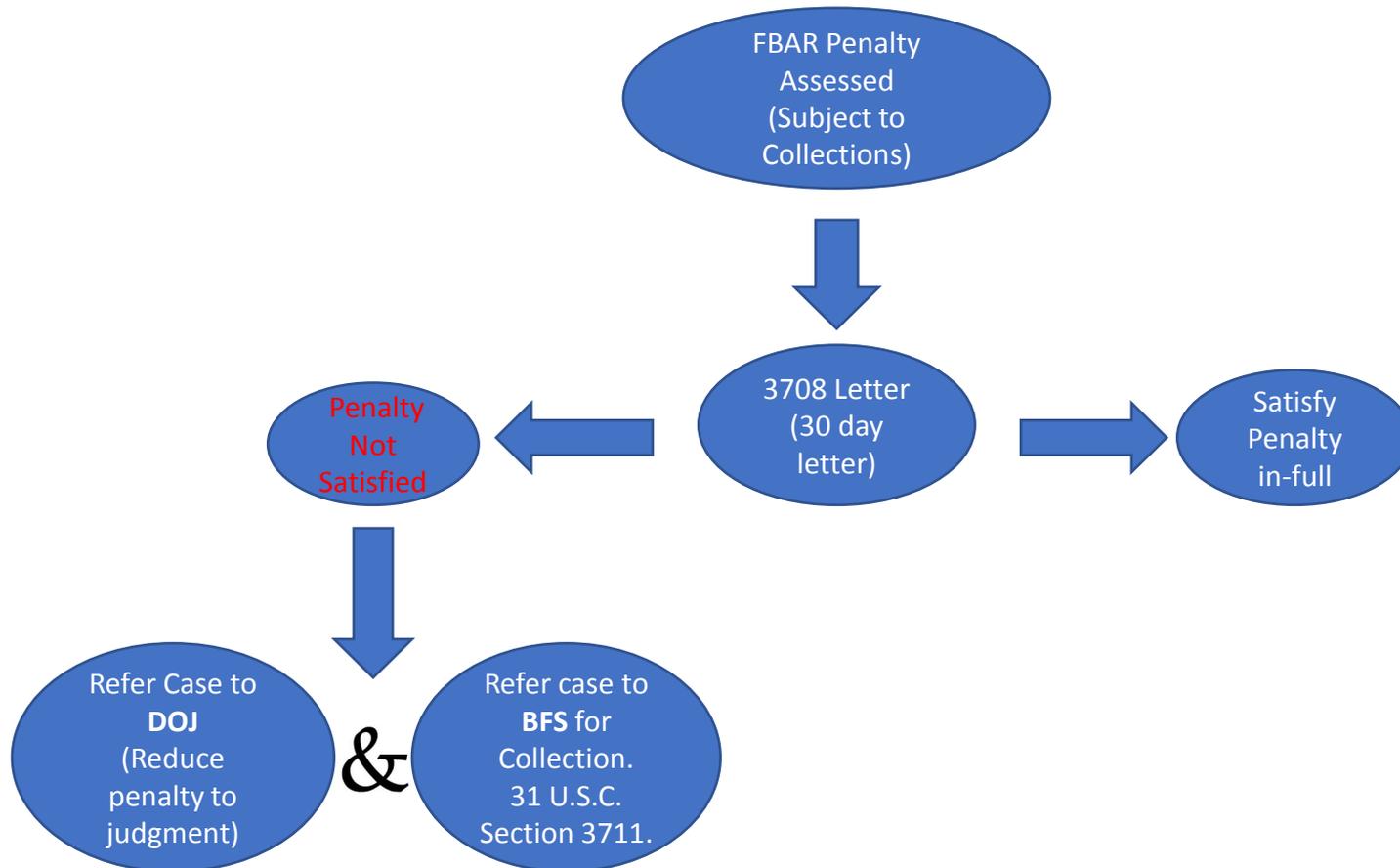
# Collection of FBAR Penalty Assessment

- 31 U.S.C. Section 3711(g)(9) Available debt collection methods include:
  - Administrative offset;
  - Federal tax refund offset;
  - Federal salary offset;
  - Non-federal employee wage garnishment;
  - Debt referral to private collection contracts;
  - Debt referral to agencies operating a debt collection center;
  - Reporting of delinquencies to credit reporting bureaus;
  - Litigation or Foreclosure.
- Collections triggered after failure to pay after issuance of **3708 Letter** (30 days letter).
- Interest will accrue from the notice date for the amounts assessed to the debtor if not paid within 30 days of 3708 Letter. 31 U.S.C. Section 3717(b).
- In addition, an annual six percent delinquency penalty is assessed on FBAR penalties that remain unpaid after the assessment. 31 U.S.C. Section 3717(e)(2).

# Collection- Administrative Offsets

- Administrative offsets. 31 U.S.C. Section 3716.
  - Including levy on Social Security benefits.
- **No statute of limitations** on collections for administrative offsets.

# Timeline Regarding Collecting FBAR Penalty





# PART TWO

## Potential Application of APA to FBAR Penalty Defenses

# Administrative Procedure Act (APA)

- Definition
  - The APA governs the way in which administrative agencies may establish regulations. The APA also provides that federal agencies may not take final actions that are arbitrary and capricious.
- Overview
  - A federal agency may not take final actions that are **arbitrary and capricious** or an **abuse of discretion**.
  - A federal agency may not engage in a prescribed rule-making or regulation process unless the public is provided with **proper notice and comment**.
  - Since FBAR penalties are imposed under Title 31 and not under the IRC, it is not subject to 26 U.S.C. Section 7421(a)
    - 26 U.S.C. Section 7421(a) prohibits suits brought for the purpose of restraining the assessment or collection of tax, thus making FBAR penalties susceptible to a challenge based on the APA under 5 U.S.C. Sections 701-706.
- Judicial Remedies
  - Declaratory relief.
  - Judicial *de novo* review of assessment amount possible only if agency's fact-finding procedures are inadequate. 5 U.S.C. Section 706(2)(F).

# APA: Sovereign Immunity

- Sovereign Immunity
  - Although the APA is **not** subject to the Anti-Injunction Act of 26 U.S.C. Section 7421(a), it **is** subject to a defense under sovereign immunity.
  - Sovereign immunity prevents suits from being brought against the government.
  - Sovereign immunity can be **waived** by the government.
    - Congress enacted the APA as a waiver of sovereign immunity.
  - Under 5 U.S.C. Section 702, “An action in a court of the United States seeking relief other than money damages... shall not be dismissed nor relief therein be denied on the ground that it is against the United States.”
    - This includes actions to set aside agency orders or rules or, more generally, actions for declaratory and injunctive relief in respect to some agency action or inaction.
  - No money damages under the APA . 

# APA: Sovereign Immunity

- Waiver of Sovereign Immunity.
  - APA provides waiver of sovereign immunity when **two prerequisites** met:

Action must “seek relief other than money damages and state a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority.” 5 U.S.C. Section 702



Plaintiff must show that:

- 1) Review of the agency action in question is authorized by a substantive statute

**OR**

- 2) Review is made of a “financial agency action for which there is no other adequate remedy in a court.” 5 U.S.C. Section 704.

- **Litigant must satisfy BOTH Section 702 and Section 704.**
- Other waivers of sovereign immunity include “Little Tucker” and Tucker Act.

# Moore: *De novo* Review

- Moore v. United States of America, No. C13-2063RAJ (W.D. Wash. 4/1/15); No. C13-2063RAJ (W.D. Wash. 7/24/15).
  - *De novo* Review
    - Court conducted a *de novo* review on whether the taxpayer was subject to the non-willful penalty.

# Moore

- Moore v. United States of America, No. C13-2063RAJ (W.D. Wash. 4/1/15); No. C13-2063RAJ (W.D. Wash. 7/24/15).
  - Court's review of IRS' procedure for assessing FBAR penalties to determine if IRS acted **arbitrarily and capriciously**.
    - Court determined that statutes and regulations are **silent** as to what procedures are necessary to assess FBAR penalties.
    - Court stated that the only requirements are the limitations imposed by the **Due Process Clause** and **Section 555 of the APA**.
    - Both the Due Process Clause and Section 555 of the APA provide the IRS with **considerable latitude** to fashion its own procedures to assess FBAR penalties.

# Moore

- Moore v. United States of America, No. C13-2063RAJ (W.D. Wash. 4/1/15); No. C13-2063RAJ (W.D. Wash. 7/24/15).
  - Administrative record in Moore devoid of any explanation of IRS' reasons for imposing maximum non-willful penalties.
  - Court stated it could **not determine** from the record if the IRS acted arbitrarily or capriciously or in abuse of its discretion.
  - Court ordered the government to supplement the record.
  - Government **refused** to produce an "Appeals Memo".
    - Government claimed **deliberative process privilege**.
  - Government moved for summary judgment.
  - Government produced "Appeals memo."
- Court determined that government's behavior in refusing to disclose the basis for its decision to plaintiff before litigation **WAS** arbitrary and capricious.
- Court determined Appeals memo was sufficient basis for determining assessment of penalty. Therefore assessment of penalty **WAS NOT** arbitrary and capricious
- Because of IRS' arbitrary and capricious conduct, all late fees, interest and supplemental assessments voided.

# Kentera

- Kentera v. United States of America, No. 2:16-cv-01020 (E.D. Wis. 1/30/17).
  - Like Moore, APA was utilized in Kentera to **challenge the manner** in which the IRS assessed FBAR penalties as being arbitrary and capricious.
  - Government moved to dismiss
    - On the grounds that sovereign immunity was not waived in Kentera under the APA.
    - In Moore, government did **not** claim that sovereign immunity was not waived.
    - Kentera court determined sovereign immunity **not waived** because plaintiff had an adequate remedy in a federal court:
      - “Little Tucker” Act **OR**
      - Tucker Act

# Kentera and the Tucker Act

- Kentera v. United States of America, No. 2:16-cv-01020 (E.D. Wis. 1/30/17).
- Tucker Act
  - CFC has “jurisdiction to render judgment upon any claim against the U.S., founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort.” 28 U.S.C. Section 1491(a)(1).
  - Waiver of **sovereign immunity** for such claims.
  - Provides CFC **jurisdiction**.
    - To have jurisdiction, the Tucker Act must be combined with a **money mandating statute** (source of substantive law that creates for a damages remedy).
    - Kentera Court determined that the Bank Secrecy Act (BSA) qualified as money-mandating.
      - “Though the BSA admittedly lacks money-mandating language, it is by necessary implication that the taxpayer has a monetary remedy– the return of his illegally exacted funds– when the statute is violated.”
  - The Tucker Act **does not** grant court with authority to issue **declaratory relief**.

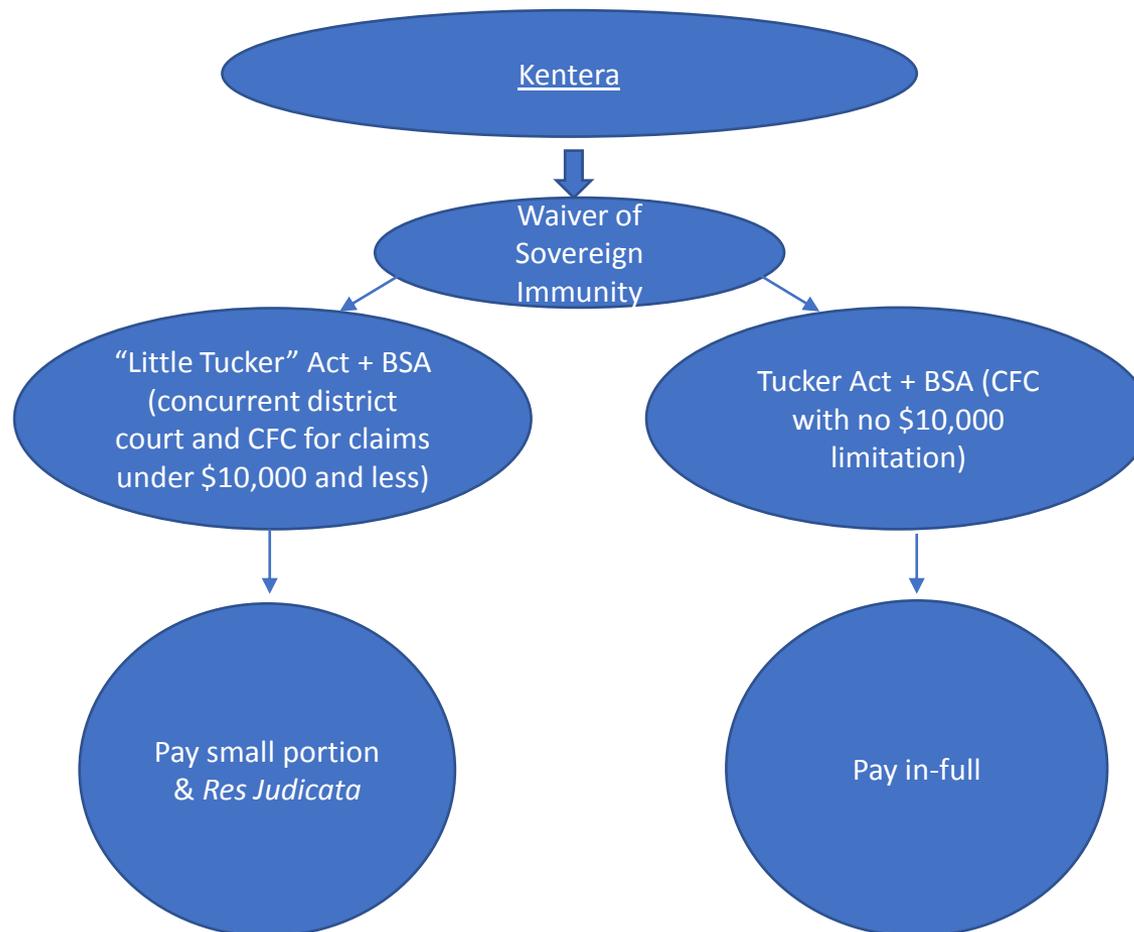
# Norman and the Tucker Act

- Mindy P. Norman v. the United States, 126 Fed. Cl. 277 (2016).
  - IRS assessed **willful penalty**.
  - Plaintiff paid in-full, filed both claim for refund and proceeded with action before the CFC.
  - Government moved to dismiss on basis that the CFC lacks **subject matter jurisdiction**.
    - Government position: U.S. district courts hold **exclusive jurisdiction** over cases involving penalties in 28 U.S.C. Section 1355.
    - “The district courts shall have original jurisdiction, exclusive of the courts of the States, of any action or proceeding for the recovery or enforcement of any fine, penalty, or forfeiture, pecuniary or otherwise, incurred under any Act of Congress, except matters within the jurisdiction of the Court of International Trade under Section 1582 of this title.” 28 U.S.C. Section 1355.
- “**Illegal exaction**” cause of action
  - When money is “improperly paid, exacted, or taken from the claimant” in violation of the Constitution or some statutory power.
  - Norman- Only case currently discussing Tucker Act in relation to FBAR penalties.
- **Holdings:** Federal Circuit previously stated that 28 U.S.C. Section 1355 **does not** create a presumption that district courts must uniquely determine and assess, as well as enforce, all civil penalties. San Juan New Materials High Tech. Inc. v. Int’l Trade Commissioner, 161 F.3d 1347 (Fed. Cir. 1998). Therefore, CFC had subject matter jurisdiction to hear FBAR penalty case.

# Kentera and the “Little Tucker” Act

- Kentera v. United States of America, No. 2:16-cv-01020 (E.D. Wis. 1/30/17).
- “Little Tucker” Act
  - Suits against the U.S. for \$10,000 or less founded upon “the Constitution, or any Act of Congress,... or upon any express or implied contract with the United States.” 28 U.S.C. Section 1346(a)(2).
  - Waiver of **sovereign immunity** for such claims.
  - As with Tucker Act, concurrent **jurisdiction** (district courts & Court of Federal Claims “CFC”)
    - To have jurisdiction, “Little Tucker” Act subsumes Tucker Act requirement that there be a **money-mandating statute**.
    - Kentera Court determined that the Bank Secrecy Act (BSA) qualified as money-mandating.
      - “Though the BSA admittedly lacks money-mandating language, it is by necessary implication that the taxpayer has a monetary remedy– the return of his illegally exacted funds– when the statute is violated.”
  - The “Little Tucker” Act **does not** grant court with authority to issue **declaratory relief**.
- Plaintiff can make a small partial payment of an FBAR penalty and sue for a return of monies illegally exacted. If plaintiff were to prevail, government would be barred by *res judicata* from seeking to collect the remainder of the assessment.
  - There is **no guidance** regarding how small the partial payment needs to be.

# Kentera: “Little Tucker” and Tucker Act





# PART THREE

Strategic Considerations for Determining  
Whether to Make an APA Argument

# Strategic Considerations

- A suit under the APA alleging only that the IRS acted **arbitrarily and capriciously** or abused its discretion in assessing an FBAR penalty is likely foreclosed under Kentera.
  - This is because adequate remedies are available in a federal court under the “Little Tucker” Act or the Tucker Act.
- However, Kentera does not entirely eliminate APA claims in FBAR cases.

# Strategic Considerations post Kentera

- Under the APA, a court may possibly still review an IRS penalty assessment for “**substantial evidence**”. 5 U.S.C. Section 706(2)(e).
- **Example**
  - IRM Exhibit 4.26.16-1 provides guidelines for “mitigating” FBAR penalties based solely on maximum balance in the accounts without taking into account the facts and circumstances of the case.
  - **Could this be challenged as arbitrary and capricious under the APA?\***
  - **Could this be challenged for lack of Notice and Comment rulemaking?\***
  - **Unlike the challenge in Moore or Kentera, in this example, a remedy would require declaratory relief. Since the “Little Tucker” and Tucker Act do not grant a court with declaratory relief, there would potentially be “no adequate remedy in court.”**

\* See *Civil & Criminal Penalties Committee of ABA Section of Taxation Flaws in the Façade: The Anti-Injunction Act After NFIB v. Sibelius and Cohen v. United States*. (September 15, 2012).

# PART FOUR

## Considerations in Developing an FBAR Litigation Strategy

# Timing Issues

- Contrary to assessments of income tax and tax related penalties, the IRS has **no collection authority** over FBAR penalties once assessed.
- If an individual who was assessed an FBAR penalty refuses to satisfy the assessment, the government's ability to collect an FBAR penalty is **limited** in most cases **to certain wage garnishments and offsets against government payments** such as tax refunds and Social Security payments.
  - **Unless** the penalty is timely liquidated into a judgment.
- Government's ability to collect an FBAR penalty prior to obtaining a judgment is not as strong as the IRS' ability to collect an unpaid tax liability.

# Timing Issues

- An account holder assessed an FBAR penalty (or penalties) who decides to bring suit against the government with only a **partial payment** of an FBAR penalty (or penalties) must be mindful that the DOJ will likely **countersue** the litigant for the remainder of the FBAR penalties assessed by the IRS.
- What is not determined at this time is whether or not the DOJ can **countersue** an FBAR litigant **if more than two years have elapsed** since an IRS assessment of an FBAR penalty.
- The downside of either waiting for the DOJ to bring suit to liquidate an FBAR penalty into a judgment or not satisfying an FBAR penalty (or penalties) is that **interest and penalties** on the FBAR penalty **increase rapidly**.
- If account holder is concerned about accruing interest/penalties, or harm caused by Section 3711 remedies, then if account holder has the means, he or she could satisfy the penalty **in full** and attempt to litigate under the Tucker Act. However, CFC jurisdiction is unsettled as of this date.

# Timing Issues

- An account holder's lawyer must carefully review the facts and circumstances of the case to determine if it makes sense to **delay paying** a penalty to wait out the statute of limitations on liquidating an FBAR penalty to a judgment, or to proceed with an **APA claim**, or **partial payment** litigation against the government and if so, when should such a case proceed.
- Interest and penalties increase readily on FBAR penalties. For example, "an assessed penalty of \$1 million that remains unpaid for two years is subject to delinquency penalties of 12 percent (i.e. 6 percent annually), plus collection costs of approximately 18 percent, and interest of approximately 2 percent (at the current annual rate of approximately 1 percent), for a total of 32 percent or \$320,000."
  - See Larry R. Kemm, CPA, J.D., *Developing a Strategy to Fight FBAR Penalties*, The Tax Advisor (May 1, 2017), <http://www.thetaxadviser.com/issues/2017/may/developing-strategy-fight-fbar-penalties.html>.

# Considerations in Designing an FBAR Litigation Strategy

- Compare district court decisions where account holder resides v. decisions emanating from CFC, if any.
- Remedy not monetary?
  - If remedy not monetary such as declaratory relief, can a case proceed under APA theory?
- Dual track causes of action (APA & Little Tucker) (adequate relief is not just money therefore seeking declaratory relief under APA)?
  - Can a position be taken that there is an imbedded bias by the IRS against account holders?
- Consider taxpayer's capacity to pay what's owed.
- Must be cognizant of accruing interest and penalties.
- Are there other dangers to litigation?
  - Can the IRS discovery of facts of accounts held prior to years being litigated trigger additional audits?
  - Could civil litigation of FBAR penalties result in damaging admissions that could be utilized in a criminal investigation?
- FBAR penalty assessments can be substantial and financially devastating. The facts and circumstances of each case will need to be determined for purposes of available defenses. If it is determined a case can be litigated under the APA or "Little Tucker" Act, careful consideration must be given to all defenses to be litigated.