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Third Circuit Affirms Dual Canadian-U.S. Citizen Is Liable for FBAR Penalties in 'United States v. Collins' as Recklessness Is Willful

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THE CASE

The recent opinion of the Third Circuit Court of Appeals in *United States v. Collins*,¹ is neither groundbreaking nor novel. Nonetheless, it is instructive as it presents many of the arguments proffered by taxpayers exposed to FBAR penalties on undisclosed foreign accounts and illustrates the ease with which courts dismiss those arguments. The taxpayer, Richard Collins, is a dual Canadian and U.S. citizen who worked as a professor in the United States, France, and Canada since the 1960s. Mr. Collins not only opened bank accounts in the three countries in which he lived, but he also opened a Swiss bank account in the 1970s even though he never lived in Switzerland. He did not report any of his foreign bank accounts until submitting amended U.S. income tax returns in 2010 as a participant in the IRS's Offshore Voluntary Disclosure Program (OVDP). Although he was accepted into the OVDP and filed amended income tax returns for the years 2002 through 2009, he withdrew

from the ODVP shortly thereafter. His withdrawal prompted an audit in which the IRS assessed additional tax as a result of his investment in a foreign mutual fund which U.S. law regards as a passive foreign investment company (PFIC).² In addition, the IRS assessed civil penalties of \$154,032 under 31 U.S.C. §5321(a)(5) for each of 2007 and 2008 for his willful failure to report his foreign financial accounts in those years.

It is worth noting that the amount of tax owed by Mr. Collins on his foreign accounts and investments was significantly less than the FBAR penalties asserted by the IRS. The amended returns he filed for 2002 through 2009 under the OVDP yielded a small refund. On examination of those returns after his withdrawal from the OVDP, the IRS assessed \$71,324 in tax, interest, and penalties for years 2005 through 2007 as a result of the PFIC investment.

Since its enactment in 1970, the Bank Secrecy Act (formerly, the Currency and Foreign Transactions Reporting Act of 1970) has required U.S. citizens to maintain records and file reports regarding transactions and relationships with foreign financial institutions.³ Initially, Treasury regulations imposed the annual reporting obligation on any person "having a financial interest in, or signature authority over a bank, securities, or other financial account in a foreign country" for each year of its existence without regard to the account balance.⁴ In 1987, the reporting obligation was limited to those individuals whose foreign financial accounts have an aggregate balance in excess of \$10,000 at any time during the calendar year.⁵

31 U.S.C. §5321(a)(5)(C)(i) and §5321(a)(5)(D)(ii) imposes penalties equal to the greater of \$100,000 or

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¹ 36 F.4th 487 (3d Cir. June 6, 2022) *aff'd* 127 AFTR2d 2021-854, 2021 WL 456962 (W.D. Pa. 2021).

² See 36 F.4th 487, 490.

³ See Pub. L. No. 91-508 (Oct. 26, 1970), tit. II, sec. 241(a).

⁴ 31 C.F.R. §103.24, 42 Fed. Reg. 63,774 (Dec. 8, 1977).

⁵ See 31 C.F.R. §103.26(c), 52 Fed. Reg. 11,443 (Apr. 8, 1987). Disclosure of foreign financial accounts is made by filing FinCEN Report 114 (formerly Form TD-F 90-22.1).

50% of the account balance for each willful failure to disclose a foreign financial account.⁶ Based on the number of Mr. Collins's undisclosed foreign financial accounts and the balances in those accounts, the statutory penalty could have exceeded a million dollars. The IRS significantly mitigated the willful penalty assessed against Mr. Collins. He did not protest the IRS's penalty calculations but rather challenged its determination that his failure to report his foreign accounts was willful. He also maintained he might have been assessed fewer penalties if he had remained in the ODVP. IRS Appeals, unpersuaded by his arguments, sustained assessment of willful FBAR penalties against him as calculated on examination.

District Court

In a one-day bench trial, the U.S. District Court for the Western District of Pennsylvania upheld the IRS's FBAR penalty assessments despite Mr. Collins's argument to excuse his conduct based on what the district court described as "a multitude of objectively unreasonable beliefs." Those beliefs are worth noting because they are the same as or similar to many offered by taxpayers in a similar position. To wit:

- Filing a Form W-9 with one bank satisfies all U.S. reporting obligations for all foreign accounts (including accounts at other banks that were not furnished a Form W-9).
- The U.S. embassy in Paris advised Mr. Collins in the 1970s that he did not have any reporting obligations to the IRS.
- As long as his foreign banks withheld taxes, Mr. Collins had no obligation to disclose his accounts to the IRS (although he did not ensure UBS withheld on his account, which held at least \$861,700 in 2008).
- Disclosing his foreign accounts to his U.S. accountant would have increased the cost of preparing Mr. Collins's tax returns.
- Swiss bank secrecy laws prevented Mr. Collins from disclosing his foreign accounts to his accountant.

In addition to bluntly stating its opinion regarding Mr. Collins's beliefs, the district court concluded that he had engaged in a "decades-long course of conduct, omission and *scienter*" in failing to disclose his foreign accounts. The court found that the penalties asserted by the IRS were not capped at \$100,000 (despite Treasury's failure to amend a 1987 regulation setting forth that amount after the statutory willfulness

penalty was increased in 2004), that they were not "fines" or "excessive" by Eighth Amendment standards, and that they were not an abuse of discretion, or arbitrary or capricious.

Court of Appeals

Unhappy with his results in district court, Mr. Collins appealed to the Third Circuit, asserting four arguments.

- The district court's finding that his failure to report his foreign bank accounts was willful was in error.
- The IRS abused its discretion in determining the amount of the FBAR penalty.
- The district court was in error in limiting his discovery regarding the manner in which the FBAR penalty was computed.
- The district court was also in error in imposing interest and penalties pursuant to 31 U.S.C. §3717.

If it could be established that Mr. Collins's failure to file FBARs was due to mere negligence instead of a willful failure to file, the FBAR penalties would be capped at \$10,000 per account per year.⁷ However, the standard of willfulness used in the Third Circuit is well-settled by established precedent. "Though 'willfulness' may have many meanings, general consensus among courts is that, in the civil context, the term 'often denotes that which is intentional, or knowing, or voluntary, as distinguished from accidental, and that it is employed to characterize conduct marked by careless disregard whether or not one has the right so to act.'"⁸ The court noted that willfulness "encompasses recklessness" in the case of FBAR penalties. "Recklessness" is "conduct that violates 'an objective standard: action entailing an unjustifiably high risk of harm that is either known or so obvious that it should be known.'"⁹ Distilling these concepts of willfulness and recklessness into a simple standard for

⁷ 31 U.S.C. §5321(a)(5)(B)(i). I.R.M. §4.26.16.5.4(4)706 (06-24-2021). See also I.R.M. §4.26.16.5.4.1(4)a. ("Since FBAR penalties are determined under the statute on a per-violation basis. . . .") The \$10,000 amount is adjusted for inflation. 31 C.F.R. §10101.821. The inflation-adjusted amount in 2022 is \$14,489. I.R.M. §4.26.16.5.4(5) (06-24-2021). However, even if mitigation criteria are not met, IRS examiners are directed to consider limiting the penalty for each year to the statutory maximum penalty amount for a single violation, regardless of the number of "non-willful violations." I.R.M. §4.26.16.5.4.1(4)a.

⁸ *Bedrosian v. United States*, 912 F.3d 144, 152 (3d Cir. 2018) (quoting *Wehr v. Burroughs Corp.*, 619 F.2d 276, 281 (3d Cir. 1980) quoting *United States v. Ill. Cent. R.R.*, 303 U.S. 239, 242-43, 58 S. Ct. 533, 82 L. Ed. 773 (1938)).

⁹ 36 F.4th 487-491 (quoting *Bedrosian v. United States*, 912 F.3d 144, 153 (3d Cir. 2018)) (quoting *Safeco Ins. Co. of Am. v.*

⁶ The base amount set forth in the statute is subject to an inflation adjustment. 31 C.F.R. §1010.821. The inflation-adjusted amount in 2022 is \$144,886.

application to Mr. Collins, the question framed by the Third Circuit was “whether Collins knew or ‘(1) clearly ought to have known that (2) there was a grave risk’ that he was not complying with the reporting requirement, ‘and if (3) he . . . was in a position to find out for certain very easily.’”¹⁰

In response to the question of willfulness, Mr. Collins responded that he made “an honest mistake” and faulted the district court for not considering that he, his accountant, and lawyer all believed he owed no tax. Since his “experienced accountant” was unaware of the FBAR reporting requirement, Mr. Collins should not be expected to be aware of that requirement. He argued his good faith was apparent from his prompt payment of the PFIC tax, once assessed.

The problem for Mr. Collins and other taxpayers claiming ignorance of their foreign account reporting obligations is that since 1976 Schedule B to Form 1040 has included a check-the-box question regarding the existence of foreign accounts and has directed taxpayers who respond affirmatively to the appropriate form on which existence of those accounts is to be reported.¹¹ Generally, the taxpayer’s subjective knowledge is irrelevant. Subjective beliefs held by a taxpayer are “at best, tangential” to whether the taxpayer should know he has an obligation to report his interest in foreign financial accounts.¹² Subsequent compliance is equally ineffective as a shield. “And it is wrong to suggest that ‘a voluntary correction . . . should be legally sufficient to negate willfulness as a matter of law.’”¹³

The Third Circuit was similarly dismissive of Mr. Collins’s complaints with the manner in which the IRS computed the penalty for his willful failure to file FBAR forms for the years in question. Reviewing the penalty assessment, the Third Circuit applied the standard used by the district court. “Courts will set aside the IRS’s determination of a penalty only if was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”¹⁴ An agency determination will uphold “where there is a rational connection

between the facts found and the choice made.”¹⁵ The Third Circuit also noted that the means by which the IRS enforces the provisions and purposes of the Bank Secrecy Act are entitled to “heightened deference” with regard to the penalty assessment.¹⁶

Although the district court had reviewed the IRS’s penalty calculation on both a de novo as well as an abuse of discretion basis, the Third Circuit observed that the IRS’s record regarding the penalty computation was sufficiently complete that de novo review was inappropriate and applied an abuse of discretion standard arising from §706 of the Administrative Procedure Act. That record established that the penalty asserted by the IRS for Mr. Collins’s willful failure to file the FBARs had been “mitigated” by more than 75% from the maximum penalty prescribed by 31 U.S.C. §5321. “The revenue agent followed the Manual and the agency did not act arbitrarily. Collins’s penalty is well below the amount permitted by law and the administrative record supports a rational connection between the agency’s findings and the penalty assessed.”¹⁷

In his request for further discovery Mr. Collins hoped to exploit the interaction between the revenue agent and her supervisor regarding computation of the penalty. The supervisor had determined the penalty initially asserted by the revenue agent was insufficient and increased the amount assessed. Although the revenue agent responsible for calculating the FBAR penalty testified at trial, Mr. Collins contended that he was entitled to discovery from the revenue agent’s supervisor as well, alleging the supervisor overruled the agent’s lower penalty calculation against the guidance of the Internal Revenue Manual (IRM). Again, the Third Circuit was unpersuaded. Multiple sections of the IRM require managers to undertake “meaningful review” of the examiner’s penalty determination.¹⁸ The record indicated the IRS followed its procedures as set forth in the IRM to determine the penalty, the IRS was not arbitrary in computing the penalty, and the district court’s unwillingness to allow further discovery did not prejudice Mr. Collins.

The final issue presented by Mr. Collins, and the one on which the Third Circuit opinion offers fresh insight, is application of the provisions of the Federal Claims Collection Act (the “Collection Act”) to the

Burr, 551 U.S. 47, 58 (2007)).

¹⁰ 36 F.4th 487 at 492 (citing *Bedrosian v. United States*, 912 F.3d 144, 153 (3d Cir. 2018)) (quoting *United States v. Carrigan*, 31 F.3d 130, 134 (3d Cir. 1994)).

¹¹ In 2007 and 2008, line 7A of Schedule B to IRS Form 1040 set forth the following question and direction: “At any time during [2007/2008], did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See Page B-2 for exceptions and filing requirements for Form TDF 90-22.1.”

¹² 36 F.4th 487 at 493.

¹³ *Id.* Quoting Collins Br. citing *United States v. Klausner*, 80 F.3d 55, 63 (2d Cir. 1996).

¹⁴ 36 F.4th 487 at 493 citing *Kimble v. United States*, 991 F.3d

1238, 1243.

¹⁵ 36 F.4th 487 at 493 (quoting *Frisby v. U.S. Dep’t of Hous. and Urb. Dev.*, 755 F.2d 1052, 1055 (3d Cir. 1985)) (quoting *Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962)).

¹⁶ 36 F.4th 487 at 493 citing *Sulton Chemists, Inc. v. U.S. EPA*, 281 F.3d 73, 83 (3d Cir. 2002).

¹⁷ 36 F.4th 487 at 494.

¹⁸ See I.R.M. 4.26.16.5.2(6) (06-24-2021), 4.26.16.5(6) (06-24-2021), 4.26.16.5.6(1) (06-24-2021) regarding FBAR penalties.

FBAR penalty. The Collection Act allows U.S. government agencies to charge a minimum annual rate of interest on outstanding debts.¹⁹ The interest rate is based upon the average investment rate for Treasury tax and loan accounts for the 12-month period ending on September 30 of each year rounded to the nearest percentage point. The rate is published annually before November 1 and effective for the first day of the next calendar quarter.

Mr. Collins challenged the assertion of failure-to-pay penalties under the Collection Act, arguing that such penalties

- were inappropriate because the FBAR penalty is a tax and not a debt, and
- cease to apply to debts once reduced to judgment.

The essence of Mr. Collins's argument on appeal was that the Bank Secrecy Act offers no independent authority for the government to collect additional failure to pay penalties on FBAR violations through the Collection Act. 31 U.S.C. §3701(d)(1) expressly provides that the provisions of the Collection Act imposing prejudgment interest on debts owed to the federal government does not apply to debts arising under the Internal Revenue Code. The Third Circuit rebutted the notion that the FBAR penalty is a tax, even though the FBAR provision may be construed as a revenue statute for jurisdictional purposes, because it is assessed under Title 31 (not Title 26). The Collection Act provides for interest and penalties on debts owed the U.S. government, which are broadly defined as "any amount of funds or property that has been determined by an appropriate official of the Federal Government to be owed to the United States. . . ." ²⁰ In the eyes of the court, because the FBAR penalty is not a debt under the Internal Revenue Code — inasmuch as it arose under 31 U.S.C. §5321(a)(5) for violation of the Bank Secrecy Act — it is a non-tax debt subject to the provisions of the Collection Act. The Collection Act ap-

plies in the absence of a more specific statute governing imposition of interest and other charges. "Since the Bank Secrecy Act does not fix interest or similar charges, or otherwise deprive §3717 of its effect, §3717 controls — and requires — the imposition of pre-judgment interest and penalties on the debt Collins owes to the United States." Mr. Collins deferred payment of his debt hoping to win on appeal. "The accumulation of pre-judgment interest is a risk inherent in that litigation strategy. There is no basis now to excuse Collins from the consequences of his own choice."²¹ Mr. Collins's argument that the Collection Act's failure-to-pay penalty should not apply to claims or debts once reduced to judgment was a distinction without a difference, the circuit court found.

OBSERVATIONS

United States v. Collins is instructive in the arguments made by the taxpayer as well as the court's response to those arguments. The excuses provided by Mr. Collins for his failure to report his foreign bank accounts will be familiar to any practitioner who advises U.S. persons — particularly those living abroad — regarding their U.S. tax compliance obligations. The "I didn't know" and "my advisor didn't know" excuses simply do not work. U.S. persons are expected to know they have U.S. tax and reporting obligations. With the decision of the Court of Appeals for the Federal Circuit in *Kimble v. United States*, it is now well settled that actual knowledge is not a requirement for willfulness.²² Similarly, U.S. persons, even those who are citizens of other countries, are expected to review their income tax returns and answer the questions on those returns honestly. Failure to do so is not negligent, it is reckless. As *Collins* and an increasing number of cases confirm, recklessness is willful.

²¹ 36 F.4th 487 at 496.

²² See *Kimble v. United States*, 991 F.3d 1238. See also Ward, *Wonderland Redux: The Meaning of 'Willful'*, 47 Tax Mgmt. Int'l. J. 582 (Sept. 14, 2018).

¹⁹ See 31 U.S.C. §3717(a)(1).

²⁰ 31 U.S.C. §3701(b)(1).