

PENALTIES FOR THE FAILURE TO REPORT FOREIGN FINANCIAL ACCOUNTS AND THE EXCESSIVE FINES CLAUSE OF THE EIGHTH AMENDMENT

*Matthew A. Melone**

People go to great lengths to avoid paying tax. One popular trick in the Middle Ages was to become a monk; these days, shell companies in the Caribbean are a more common retreat.[±]

[W]e have ways of getting information that people don't know about The days of waiting for a warning sign, such as a letter from a bank, are over.[‡]

INTRODUCTION

Offshore financial accounts held by U.S. citizens or residents have been the subject of government scrutiny for some time. These accounts are often maintained by taxpayers as repositories of funds derived from illegal activities or to evade income taxes on funds derived from both legal and illegal activities.¹ Recent high profile scandals, particularly those involving Swiss banks, have brought heightened congressional and public attention to the nefarious use of such accounts.² Particularly prominent was the scandal

* Professor of Law, Lehigh University, Bethlehem, PA.

± *Fiscal Blackmail*, *ECONOMIST*, May 24, 2014, at 71, 71.

‡ Laura Saunders, *The Next Offshore Target*, *WALL ST. J.*, Apr. 5, 2014, at B9 (east ed.) (quoting Assistant Attorney General Kathryn Keneally) (internal quotation marks omitted).

¹ The term “illegal activities” conjures up images of drug lords and arms smugglers. To be sure, offshore financial accounts are used to park funds from such activities. However, offshore accounts also are used to cover up more prosaic offenses such as violations of federal securities laws. See Christopher M. Matthews, *SEC Wins Tax-Fraud Case Against Wyly Brothers*, *WALL ST. J.*, May 13, 2014, at C1 (east ed.) (reporting that a jury returned a verdict against the Wyly brothers in a civil fraud suit brought by the Securities and Exchange Commission that alleged that the Wyly brothers used a complex web of offshore accounts to avoid disclosure obligations under the securities law and to assist their insider trading activity).

² See STAFF OF SUBCOMM. ON INVESTIGATIONS OF S. COMM. ON HOMELAND SECURITY & GOV'T AFFAIRS, 113TH CONG., *OFFSHORE TAX EVASION: THE EFFORT TO COLLECT UNPAID TAXES ON BILLIONS IN HIDDEN OFFSHORE ACCOUNTS* 32-35 (Comm. Print 2014) [hereinafter *OFFSHORE TAX EVASION*] (describing the activities of UBS in aiding U.S. taxpayers in evading income taxes). See also John Letzing, *U.S. Probes Swiss Insurance Plans*, *WALL ST. J.*, Feb. 24, 2014, at C1 (east ed.) (reporting that government scrutiny is not limited to banks but also extends to Swiss insurers); Ben Protes & Jessica Silver-Greenberg, *Big Swiss Bank Pleads Guilty in Felony Case*, *N.Y. TIMES*, May 20, 2014, at A1 (late ed.) (reporting that Credit Suisse Group AG has agreed to plead guilty to one count of conspir-

involving UBS, a Swiss global financial services company, and the deliberate attempts by its private banking division to aid U.S. citizens in evading income taxes. This scandal, which prompted the bank to disclose to the United States thousands of its accounts held by U.S. citizens, was brought to light by a whistleblower who, after being convicted and sentenced for conspiracy to assist tax evasion, received the largest whistleblower award in U.S. history.³

The government has employed various methods in its efforts to combat tax evasion that are facilitated through the use of offshore financial holdings. The efficacy of one method, mandatory taxpayer reporting, is abetted by the possible imposition of draconian penalties on taxpayers who fail to meet their obligation to disclose the existence of foreign financial accounts.⁴ The Eighth Amendment proscribes the imposition of excessive fines by the government.⁵ Surprisingly, the Supreme Court has provided relatively little guidance for determining when governmental monetary sanctions reach their constitutional limit.

Part I of this Article discusses and describes the foreign financial account reporting obligations and the penalties imposed on taxpayers for the failure to meet such obligations. This Part also discusses the operation of a voluntary disclosure program instituted by the Internal Revenue Service (“IRS”) to encourage, by means of a significantly less harsh penalty regime, taxpayer disclosure. In addition, related statutory reporting and penalty provisions are canvassed. This Part concludes with an example that illustrates the severity of the statutory failure to report penalties in comparison to both the statutory penalties for tax evasion and the failure to report penalties under the voluntary disclosure program.

ing to aid tax evasion and will pay approximately \$2.6 billion in penalties); Laura Saunders, *Offshore-Adviser Plea Marks a Shift*, WALL ST. J., Aug. 24, 2013, at B9 (east ed.) (reporting on the United States’ willingness to strike deals with individual financial advisers who aid U.S. taxpayers in evading tax); Laura Saunders & John Letzing, *U.S. Nears Swiss-Bank Deal*, WALL ST. J., Aug. 29, 2013, at C1 (east ed.) (reporting on settlement talks between the United States and Swiss banks). Swiss financial institutions are not the only ones to garner public attention. Beanie Baby creator Ty Warner was assessed a \$54 million fine and criminal sanctions. See Laura Saunders & Mark Peters, *Beanie Toy Billionaire Hit with \$54 Million Tax Fine*, WALL ST. J., Sept. 19, 2013, at B2 (east ed.). The alacrity with which the government has policed this area has resulted in a record number of individuals renouncing citizenship or permanent residency status. See Liam Plevin & Laura Saunders, *More Taxpayers Depart U.S.*, WALL ST. J., Aug. 10, 2013, at B2 (east ed.).

³ See Dina ElBoghdady, *Whistleblower Gets \$104 Million in UBS Tax Case*, WASH. POST, Sept. 12, 2012, at A12; Paul Sullivan, *The Price Whistle-Blowers Pay for Secrets*, N.Y. TIMES, Sept. 22, 2012, at B1 (late ed.). Employees at Credit Suisse Group have also been active in aiding U.S. taxpayers’ efforts to evade income tax. See Andrew Grossman et al., *Plea Deal Shows Trail of Tax Fraud*, WALL ST. J., Mar. 13, 2014, at C3 (east ed.) (reporting on the actions of a prominent banker at Credit Suisse Group and the indictment of him and seven others in 2011 for conspiracy).

⁴ See Kevin E. Packman, *Noncompliance After the IRS Offshore Income Reporting Initiative—What Options Remain?*, 111 J. TAX’N 281, 287 (2009).

⁵ U.S. CONST. amend. VIII.

Part II reviews and analyzes the meager Supreme Court precedents with respect to the Excessive Fines Clause of the Eighth Amendment. All of recent vintage, the Court's holdings make clear that the Eighth Amendment has application to civil fines. In deference to the legislative branch and in recognition of the judiciary's lack of expertise in assessing societal harms, the Court requires a showing of gross disproportionality between a fine and the offense for which it is imposed in order for such fine to be offensive to the Eighth Amendment. Regrettably, the Court has not provided an easy-to-apply, formulaic method to assist taxpayers in making this showing.

Part III asserts that, under appropriate circumstances, the penalties imposed for the failure to report foreign financial accounts are constitutionally excessive. The factors employed by the Court in determining gross disproportionality do not yield consistent results in the context of these penalties. However, this Part argues that, despite the admittedly significant societal harm caused by tax evasion, the penalties that may be imposed are grossly disproportionate to the offense—a reporting offense—for which such penalties may be imposed. The application of the gross disproportionality test to fines for a reporting offense that assists in the commission of a tax evasion offense should be supplemented with the existence of a robust and harsh regime of civil penalties for the latter offense. It is counterintuitive that the statutory penalties should punish the reporting offense much more harshly than the offense for which the reporting rules were designed to prevent. Moreover, the enforcement of the reporting penalties, particularly the significant reduction in penalties under the voluntary disclosure program, provides evidence that the statutory penalties are excessive relative to the punished offense.

I. FOREIGN FINANCIAL ACCOUNT REPORTING RULES

A. *In General*

The Banks Records and Foreign Transactions Act, better known as the Bank Secrecy Act (“BSA”), was enacted in 1970 in an effort to combat money laundering and tax evasion.⁶ For the most part, this legislation enlisted financial institutions to assist the government in its efforts through the imposition of a variety of recordkeeping and reporting obligations on such institutions.⁷ Numerous amendments were made to the BSA over the years in order to strengthen efforts to combat money laundering and, more recent-

⁶ Bank Records and Foreign Transactions Act, Pub. L. No. 91-508, 84 Stat. 1114 (1970). See H.R. REP. NO. 91-975, at 1 (1970), *reprinted in* 1970 U.S.C.C.A.N. 4394, 4397-98.

⁷ Bank Records and Foreign Transactions Act, Pub. L. No. 91-508, §§ 101-223, 84 Stat. 1114, 1114-22 (1970).

ly, to aid in counterterrorism activities.⁸ As subsequently discussed in detail, statutory duties were not limited to those imposed on financial institutions.⁹ The legislation also imposes certain reporting obligations on foreign financial account holders, and recent tax legislation imposes an additional, albeit somewhat related, reporting duty on such account holders.¹⁰ Moreover, government efforts to deter, detect, and punish tax evasion have not been confined to these legislative enactments.

The United States has used, and continues to use, various means to ferret out the use of foreign financial accounts for tax evasion purposes.¹¹ The United States is a party to more than 140 tax treaties, tax information exchange agreements, mutual legal assistance treaties, and other information exchange agreements with almost 100 foreign jurisdictions.¹² In tax treaties and tax information exchange agreements, the United States attempts to include information exchange provisions that encompass any information “relevant for carrying out the provisions” of U.S. tax law.¹³

The United States, in addition to enlisting foreign tax authorities in its quest for information, enlists the aid of foreign financial institutions. The Qualified Intermediary Program, a program limited to foreign financial institutions that purchased and sold U.S. securities through accounts in U.S. financial institutions, required U.S. financial institutions to withhold 30 percent of income earned on U.S. investments held in foreign accounts unless the foreign financial institution provided the U.S. withholding agent with the names of the foreign accounts’ beneficial owners.¹⁴ More recently,

⁸ For an excellent summary of the various legislative developments after the passage of the 1970 legislation, see AM. BANKERS ASS’N, A NEW FRAMEWORK FOR PARTNERSHIP: RECOMMENDATIONS FOR BANK SECRECY ACT / ANTI-MONEY LAUNDERING REFORM app. C at C1-C29 (2008), available at <http://www.aba.com/Compliance/Documents/39225789ccea407ab9e298aa35984b6fABABSARReport2008.pdf>.

⁹ See *infra* notes 21-35 and accompanying text.

¹⁰ See *infra* notes 98-117 and accompanying text.

¹¹ Switzerland is not the exclusive recipient of the IRS’s attention. The agency recently has begun to focus significant investigative resources on the Cayman Islands. See Laura Saunders, *The Next Off-shore Target*, WALL ST. J., Apr. 5, 2014, at B9 (east ed.).

¹² See U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-11-730, TAX ADMINISTRATION: IRS’S INFORMATION EXCHANGES WITH OTHER COUNTRIES COULD BE IMPROVED THROUGH BETTER PERFORMANCE INFORMATION 12-13 (2011), available at <http://www.gao.gov/assets/590/585299.pdf>. Mutual Legal Assistance Treaties generally limit information exchanges to criminal matters. *Id.* at 20.

¹³ See U.S. MODEL INCOME TAX CONVENTION OF NOVEMBER 15, 2006, art. 26, available at <http://www.irs.gov/pub/irs-trty/model006.pdf>. Tax Information Exchange Agreements had their genesis in the Interest and Dividend Tax Compliance Act of 1983, Pub. L. No. 98-67, § 222, 97 Stat. 369, 395-96 (1983), and became more commonplace after the Organisation for Economic Cooperation and Development published a model agreement about a decade ago. See ORGANISATION FOR ECON. COOPERATION & DEV., AGREEMENT ON EXCHANGE OF INFORMATION ON TAX MATTERS (2002), available at <http://www.oecd.org/ctp/exchange-of-tax-information/2082215.pdf>.

¹⁴ See generally Treas. Reg. § 1.1441-1(b)(1) (2007). The details of this program are beyond the scope of this work. This program had some serious deficiencies, including the fact that qualified inter-

and more importantly, the enactment of the Foreign Account Tax Compliance Act (“FATCA”) requires foreign financial institutions to disclose foreign accounts held by U.S. persons or by non-U.S. persons that are entities substantially controlled by U.S. persons.¹⁵ Failure to do so will cause the offending institution to incur a 30 percent withholding tax on all investment income received from U.S. sources.¹⁶ Predictably, FATCA has been the subject of criticism due to the unilateral and extraterritorial enlistment of

mediaries did not have to report the identities of non-U.S. clients to the IRS provided that the qualified intermediaries concluded that proper withholding of U.S. tax was made on U.S. source income. Consequently, U.S. shareholders that controlled foreign corporations often escaped identification. *See generally* Treas. Reg. § 1.6045-1(a)(1) (2013); Treas. Reg. § 1.6049-5(b)(6) (2012); Treas. Reg. § 1.6042-3(b) (2000); *see also* Susan C. Morse & Stephen E. Shay, *Qualified Intermediary Status: A New U.S. Withholding Role for Foreign Financial Institutions Under Final U.S. Withholding Regulations*, 27 *TAX MGM'T INT'L J.* 331, 331-33 (1998).

¹⁵ *See* I.R.C. § 1471(c) (2012). FATCA was enacted as part of Title V of the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

¹⁶ Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 501, 124 Stat. 71, 97-106 (codified as amended at I.R.C. §§ 1471-74 (2012)). Disclosures may be made through bilateral agreements between the foreign financial institutions and the United States or through an intergovernmental agreement. *See generally* I.R.S. Notice 2013-69, 2013-46 I.R.B. 503; I.R.S. Notice 2013-43, 2013-31 I.R.B. 113. These Notices also provide revised timelines for implementation of the statute's provisions. As of April 2, 2014, twenty-six nations have executed intergovernmental agreements and an additional nineteen nations have reached agreements in substance and are treated by the Treasury Department as having agreements in place. *See* Press Release, U.S. Dep't of the Treasury, Treasury to Treat Jurisdictions with FATCA Agreements in Substance as Agreements in Effect to Prepare for Start of Law (Apr. 2, 2014), <http://www.treasury.gov/press-center/press-releases/Pages/jl2343.aspx>. FATCA also contains taxpayer disclosure requirements. *See supra* notes 15-16 and accompanying text; *infra* note 17 and accompanying text. Foreign financial institutions have had difficulty in their FATCA compliance efforts. *See* Lynnley Browning, *Complying with U.S. Tax Evasion Law Is Vexing Foreign Banks*, N.Y. TIMES, Sept. 17, 2013, at B6 (late ed.). The IRS has announced that it will treat the years 2014 and 2015 as a transition period and that it will not rigorously enforce the statute until 2016 against financial institutions that are making good-faith compliance efforts. *See* I.R.S. Notice 2014-33, 2014-21 I.R.B. 1033; *see also* John D. McKinnon & Eyk Henning, *Banks Get Break on Tax Law*, WALL ST. J., May 3, 2014, at B1 (east ed.). Some countries have dealt with the problem of tax evasion through the use of foreign accounts by different means. For example, the United Kingdom has had limited success in obtaining voluntary cooperation from its taxpayers in reporting income from offshore accounts. In 2011, the United Kingdom and Switzerland entered into a treaty that requires a Swiss paying agent to withhold tax from certain accounts and remit the tax to the United Kingdom unless the account holder consents to disclosure of the details of the account to the United Kingdom's taxing authorities. Withholding preserves the anonymity of the account holders. There are two withholding taxes under the treaty. The first is a one-off withholding tax that clears all back taxes, interest, and penalties and applies to accounts open on December 31, 2010 and still open on May 31, 2013. The withholding rate ranges from 21 to 41 percent of the account balance. The second withholding tax is an on-going tax to deal with future tax liabilities. *See generally* Agreement Between the United Kingdom of Great Britain and Northern Ireland and the Swiss Confederation on Cooperation in the Area of Taxation, Oct. 6, 2011, Treaty Series No. 9 (2013), *available at* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/190652/TS.9.2013.SwissDoubleTax.ProtEoN.pdf.

foreign financial institutions as de facto Treasury agents.¹⁷ Finally, taxpayer cooperation in providing information about the activities of foreign financial institutions is required as a condition for participation in a voluntary disclosure program designed to entice taxpayers to come clean with information about their foreign accounts and the income stored in these accounts.¹⁸

B. *Report of Foreign Bank and Financial Accounts (“FBAR”) Rules*

1. Reporting Obligations

Of course, the need for the aforementioned mechanisms and procedures would be moot if taxpayers voluntarily reported their interests in foreign accounts and the income generated from such accounts. Provisions of the BSA and the regulations promulgated pursuant to the BSA, commonly referred to as the FBAR rules, require that each U.S. person having a financial interest in, or signature authority over, bank, securities, or other financial accounts in a foreign country whose aggregate value exceeds US\$10,000 to file a FBAR with the IRS.¹⁹ Responsibility for the admin-

¹⁷ See, e.g., Arthur J. Cockfield, *The Limits of the International Tax Regime as a Commitment Projector*, 33 VA. TAX REV. 59, 102-03 (2013). Despite its critics, FATCA has served as a model for the establishment of enforcement mechanisms by other countries. On May 6, 2014, the ministers and representatives of forty-seven countries and the European Union declared their support for a single global information sharing protocol. See ORGANISATION FOR ECON. COOPERATION & DEV., DECLARATION ON AUTOMATIC EXCHANGE OF INFORMATION IN TAX MATTERS (2014), available at <http://www.oecd.org/mcm/MCM-2014-Declaration-Tax.pdf>. See also Joshua D. Blank & Ruth Mason, *Exporting FATCA*, 142 TAX NOTES 1245, 1247 (2014) (discussing efforts by the United Kingdom, the Organisation for Economic Cooperation & Development, and the G-5 countries to implement information exchange mechanisms). These efforts have led some Swiss banks to offer financial incentives to their U.S. customers to voluntarily report their financial accounts to the IRS. See *infra* note 74.

¹⁸ See *infra* note 78 and accompanying text.

¹⁹ 31 U.S.C. § 5314 (2012); 31 C.F.R. § 1010.306(c) (2011); 31 C.F.R. § 1010.350(a) (2011). Various provisions of the BSA were codified in Title 31 of the United States Code in 1982. See AM. BANKERS ASS'N, *supra* note 8, at C7-C8. The required information was reported, until recently, on Form TD-F-90.22.1, FBAR, on or before June 30 of the year following the reporting year. 31 C.F.R. § 1010.350(a). This report was not filed with an income tax return but as a separate stand-alone report whose deadline may not be extended. In September 2013, this form was replaced with a new form, FinCEN 114, that must be filed electronically. See *Important Notice to BSA E-Filers: Updated Report of Foreign Bank and Financial Accounts (FBAR), FBAR Batch Capability, and Web Site Updates*, DEP'T OF TREASURY (Sept. 30, 2013), <http://www.fincen.gov/whatsnew/html/20130930.html>. A person having a financial interest in, or signature authority over, twenty-five or more foreign financial accounts must report only the number of the financial accounts over which signature authority exists and certain other basic information, but need not report detailed information regarding each individual account unless requested to do so by the Secretary or his delegate. 31 C.F.R. § 1010.350(g)(1)-(2). A foreign country includes all geographic areas located outside the states of the United States, the District of Columbia, the Indian lands, as defined in the Indian Gaming Regulatory Act, and the Territories and Insular Posses-

istration of FBAR reporting rests with the Financial Crimes Enforcement Network (“FinCEN”), a bureau of the Department of the Treasury, although the IRS has a significant role in the policing of these rules under a Memorandum of Understanding issued in 2003.²⁰ For FBAR purposes, a U.S. person is a citizen or resident of the United States as well as trusts, estates, partnerships, corporations, limited liability companies, and other entities organized under the laws of the United States, any State, the District of Columbia, the Territories and Insular Possessions of the United States, or the Indian tribes.²¹ A bank account is defined as a “savings deposit, demand deposit, checking, or any other account maintained with a person engaged in the business of banking.”²² A securities account is an account maintained “with a person engaged in the business of buying, selling, holding or trading stock or other securities.”²³ Other financial accounts include accounts with a person that is in the business of accepting deposits as a financial agency, insurance and annuity accounts with cash values,²⁴ accounts with

sions of the United States. *Id.* § 1010.100(hhh); 31 C.F.R. § 1010.350(d). Note the broad reach of the regulations. Reporting obligations are not limited to accounts held in tax haven jurisdictions. An account is not a foreign account if it is maintained by a financial institution located in the United States regardless of the inclusion of securities of foreign entities in the account. Moreover, the maintenance of an account with a U.S. financial institution that serves as a global custodian for assets held outside the United States—so-called omnibus accounts—is not subject to reporting provided that the holder of the account cannot access her foreign holdings directly. *See* Amendment to the Bank Secrecy Act Regulations—Reports of Foreign Financial Accounts, 76 Fed. Reg. 10,234, 10,235 (Feb. 24, 2011). FATCA also requires taxpayers to provide information that is filed with the income tax return. *See infra* notes 102-04 and accompanying text.

²⁰ *See* 31 C.F.R. § 103.56(g) (2003).

²¹ 31 C.F.R. § 1010.350(b) (2011). A resident alien is an individual who has permanent residence status pursuant to the immigration laws, meets a statutory substantial presence test, or elects such status. *See* I.R.C. § 7701(b)(1) (2012). For purposes of determining residency status, the United States is defined pursuant to 31 C.F.R. § 1010.100(hhh), set forth at *supra* note 19, and not by the regulations promulgated under I.R.C. § 7701. *See* 31 C.F.R. § 1010.350(b)(2). Individuals who elect resident status are subject to the reporting requirements only during the period for which the election is effective. Amendment to the Bank Secrecy Act Regulations—Reports of Foreign Financial Accounts, 76 Fed. Reg. 10,234, 10,238 (Feb. 24, 2011). “A legal permanent resident who elects,” pursuant to a tax treaty, “to be treated as a non-resident for tax purposes” is subject to the reporting requirements. *Id.* Certain foreign entities, such as corporations engaged in real estate activities or insurance, may elect, for federal income tax purposes, to be treated as U. S. corporations. *See, e.g.*, I.R.C. §§ 897(i), 953(d) (2012). Such corporations are not subject to the reporting requirements because the reporting obligation applies only to entities organized under the laws of the United States, any State, the District of Columbia, the Territories and Insular Possessions of the United States, or the Indian tribes.

²² 31 C.F.R. § 1010.350(c)(1).

²³ *Id.* § 1010.350(c)(2).

²⁴ The term “financial agency” is defined as a person acting as a financial institution or in a similar manner related to money. *See* 31 U.S.C. § 5312(a)(1) (2012). The term “financial institution” has been given a broad interpretation. *See* *United States v. Dela Espriella*, 781 F.2d 1432, 1436-37 (9th Cir. 1986). Accordingly, a recent district court case held that online poker establishments such as PokerStars are acting as financial agencies when they hold funds in customer accounts. Therefore, these accounts are reportable by the customers. *See* *United States v. Hom*, No. C 13-03721 WHA, 2014 U.S. Dist.

brokers or dealers in commodity options or futures, and mutual funds available to the general public with a regular net asset value determination and redemption feature, or similar pooled funds.²⁵

A U.S. person has a financial interest in a specified account for any account in which such person is the owner of record or has legal title regardless of whether that person has any beneficial interest in the account.²⁶ In addition, a financial interest exists for any U.S. person if the record owner or holder of legal title is “acting as an agent, nominee, attorney or in some other capacity on behalf” of that person.²⁷ Several entity attribution rules exist that establish a financial interest in a U.S. person. First, financial interests owned by a corporation or a partnership are deemed the financial interests of direct or indirect owners of more than 50 percent of the voting power of the corporation or more than 50 percent of the interests in the profits or capital of the partnership.²⁸ Similar rules apply to any other entity in which a U.S. person owns more than 50 percent of the voting power, equity, assets, or profit interests.²⁹ Second, with respect to trust accounts, the grantor is considered to have a financial interest in such accounts if the trust is treated as a grantor trust for federal income tax purposes.³⁰ Likewise,

LEXIS 77489, at *8-11 (N.D. Cal. June 4, 2014). The reporting obligation with respect to life insurance policies resides with the owner of the policy and not the beneficiary of the policy. Amendment to the Bank Secrecy Act Regulations—Reports of Foreign Financial Accounts, 76 Fed. Reg. at 10,239.

²⁵ 31 C.F.R. § 1010.350(c)(3)(i)-(iv)(A). Accounts of a “department or agency of the United States, an Indian Tribe, or any State or any political subdivision of a State, or a wholly-owned entity, agency or instrumentality of any of the foregoing” are excluded from the definition of foreign financial accounts. *Id.* § 1010.350(c)(4)(i). Accounts of international financial institutions in which the United States is a member, accounts in U.S. military banking facilities, and certain correspondent or *nostro* accounts maintained by banks for use in bank to bank settlements are similarly excluded. *Id.* § 1010.350(c)(4)(ii)-(iv). The regulations have reserved guidance on the applicability of the reporting rules with respect to other foreign commingled funds. *Id.* § 1010.350(c)(B). The IRS announced that it will not enforce the reporting rules with respect to foreign commingled funds, including hedge and private equity funds, for calendar years prior to 2010. The special treatment of foreign investment funds is largely due to the fact that the shares in hedge funds and private equity funds are generally not available to the general public and to the fact that such funds often do not have regular net asset value determinations and/or a regular redemption feature. *See* I.R.S. Notice 2010-23, 2010-11 I.R.B. 441.

²⁶ 31 C.F.R. § 1010.350(e)(1). Consequently, citizens or residents of the United States must report foreign accounts held jointly with a non-resident alien spouse. Moreover, the fact that a U.S. person is living abroad is irrelevant to whether that person has a reporting obligation. An account maintained in the name of more than one U.S. person will trigger multiple reporting obligations because each named person would have a financial interest in the account.

²⁷ *Id.* § 1010.350(e)(2)(i).

²⁸ *Id.* § 1010.350(e)(2)(ii).

²⁹ *Id.* An entity that “owns directly or indirectly more than a 50 percent interest in one or more other entities” may “file a consolidated report on behalf of itself and such other entities.” *Id.* § 1010.350(g)(3).

³⁰ *Id.* § 1010.350(e)(2)(iii). The grantor trust rules treat the grantor of a trust, for federal income tax purposes, as the owner of all or a portion of a trust over which the grantor has retained certain powers, such as the power to revoke the trust or the power to control the beneficial enjoyment of the trust

trust beneficiaries possessing a more than 50 percent present beneficial interest in the assets or income of the trust are considered to have a financial interest in the accounts of the trust.³¹ The regulatory language is somewhat cryptic as to whether the trust rules impose a reporting obligation on the trust or on the grantor and beneficiaries. The grantor trust rules treat the grantor as the owner of the trust and, therefore, it is logical that the reporting obligation be imposed on the grantor. Moreover, domestic trusts would have a reporting obligation in any event. The exception provided for beneficiaries' reporting obligations clarifies that it is the beneficiaries who must report.³²

Signature authority over an account is the authority of any individual, whether alone or in conjunction with another, to control the disposition of money, funds, or other assets held in the financial account by direct communication, whether written or otherwise, to the person with whom the account is maintained.³³ The phrase "in conjunction with another" addresses situations in which a financial institution "requires a direct communication from more than one individual regarding the disposition of assets in the account" and is not intended to foist a reporting obligation on individuals who supervise, instruct, or participate with others with signature authority.³⁴ The reporting obligation on individuals with signature authority is not eliminated due to the fact that another person has a financial interest in the account or due to the fact that another individual also has signature authority. FinCEN expressly contemplates multiple filing obligations for the same account because information about individuals, in addition to account information, is valuable for law enforcement purposes, and duplicative re-

corpus or the income therefrom, has certain rights to income from the trust, or has certain reversionary interests. *See generally* I.R.C. §§ 671-79 (CCH 2014).

³¹ 31 C.F.R. § 1010.350(e)(2)(iv). A trust beneficiary, otherwise subject to a reporting obligation, need not report a trust's foreign accounts if the trust, trustee, "or agent of the trust is a United States person that files" the required reports. *Id.* § 1010.350(g)(5).

³² 31 C.F.R. § 1010.350(g)(5).

³³ *Id.* § 1010.350(f)(1). Officers and employees of federally supervised banks, financial institutions that are registered with and examined by the Securities and Exchange Commission or the Commodity Futures Trading Commission, certain authorized service providers to regulated investment companies, or subsidiaries of such entities with a class of equity securities listed on any U.S. national securities exchange, and entities with a class of equity securities registered under § 12(g) of the Securities Exchange Act need not file a report if such officer or employee has no financial interest in the account. *Id.* § 1010.350(f)(2). Participants and beneficiaries of qualified retirement plans and owners and beneficiaries of individual retirement accounts or Roth IRAs are not required to report the foreign financial accounts held by or on behalf of the retirement plan, individual retirement account, or Roth IRA. *Id.* § 1010.350(g)(4). Participants in other types of retirement plans will be subject to reporting under the entity attribution rules discussed at *supra* notes 27-30 and accompanying text.

³⁴ *See* Amendment to the Bank Secrecy Act Regulations—Reports of Foreign Financial Accounts, 76 Fed. Reg. 10,234, 10,236 (Feb. 24, 2011).

porting obligations mitigate the possibility that a person with a financial interest in the account fails to report.³⁵

2. Penalties

The American Jobs Creation Act of 2004 greatly increased the penalties for the failure to timely disclose foreign financial accounts.³⁶ Prior to the enactment of this legislation, the imposition of a civil penalty was limited to circumstances in which a person willfully violated the reporting or record retention obligations under 31 U.S.C. § 5314. The secretary had the burden of proving taxpayer willfulness by demonstrating that the taxpayer knew of the statutory duties and intentionally ignored those duties. According to the Supreme Court, “[w]illfulness . . . requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty [C]arrying this burden requires negating a defendant’s claim of ignorance of the law.”³⁷ The maximum penalty for failure to meet the reporting obligations was the greater of \$25,000 or the balance in the account at the time of the violation, but the penalty was not to exceed \$100,000.³⁸

The 2004 legislation increased the penalty for willful violations of the reporting obligations to the greater of \$100,000 or 50 percent of the balance of the account at the time of the violation.³⁹ Moreover, non-willful violations are subject to penalties not to exceed \$10,000.⁴⁰ Civil penalties may be imposed notwithstanding the imposition of criminal penalties.⁴¹ The statuto-

³⁵ *Id.*

³⁶ American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 821, 118 Stat. 1418, 1586.

³⁷ *Cheek v. United States*, 498 U.S. 192, 201-02 (1991).

³⁸ 31 U.S.C. § 5321(a)(5)(A) (2012).

³⁹ *Id.* § 5321(a)(5)(C)(i), (a)(5)(D)(ii). The time of the violation for the failure to report foreign financial accounts is June 30th of the year following the reporting year and the account balance at the close of this date is the amount used in the determination of the penalty. IRM 4.26.16.4.5.5 (July 1, 2008). The time of the violation for the failure to keep records is the date that the examiner first requests such records. *Id.* Penalties may be assessed within six years of the time of the transaction in question. Because this penalty is not a tax penalty imposed under the Internal Revenue Code, it is not subject to the notice of deficiency procedures pursuant to I.R.C. § 6212 and, therefore, is not subject to Tax Court jurisdiction. *See* I.R.C. § 6213 (CCH 2014). Moreover, penalties imposed under 31 U.S.C. § 5321 are not dischargeable in bankruptcy. *See* 11 U.S.C. § 523(a)(7) (2012).

⁴⁰ 31 U.S.C. § 5321(a)(5)(B)(i). Penalties for non-willful violations of the reporting or record retention obligations may be not be imposed if the failure at issue was due to reasonable cause and the balance in the account was properly reported. *Id.* § 5321(a)(5)(B)(ii). An additional penalty for negligence may be imposed on financial institutions or non-financial trades or businesses. *See id.* § 5321(a)(6).

⁴¹ 31 U.S.C. § 5321(d). Criminal penalties of up to \$250,000 in fines and imprisonment for no more than five years may be imposed. *See id.* § 5322(a). Violations of the reporting requirements that

ry language provides that the IRS “may” impose a penalty for non-willful violations, thereby indicating that a modicum of discretion is provided to the agency in dealing with non-willful violations.⁴² Moreover, the fact that the statute establishes a maximum penalty indicates that the IRS has the discretion to impose either no penalty or a penalty of less than \$10,000 for non-willful violations. The IRS has indicated that it will, in fact, exercise discretion in dealing with non-willful violations and that no penalties will be imposed upon persons who failed to file the required report but reported, and paid tax on, any taxable income generated by the accounts.⁴³ Such persons should file late reports prior to being notified that they are under examination.⁴⁴

Examiners are instructed to take into account the facts and circumstances of each case to determine whether to impose a penalty and, if a penalty is to be assessed, the amount of such penalty.⁴⁵ Moreover, mitigation guidelines have been developed to assist the examiners in the exercise of their discretion. In order for the mitigation guidelines to apply a person must have had no history of criminal tax or BSA convictions for the preceding ten years, the funds in the foreign account could not have been obtained from an illegal source or used to further criminal purposes, the person must have cooperated with the IRS during the examination, and no civil tax fraud penalty for underpayment of income tax could have been sustained against the taxpayer.⁴⁶ If these mitigation guidelines are met, then the maximum statutory penalty will be assessed only if the highest balance in the account during the period for which the report should have been filed exceeded \$250,000.⁴⁷ If the aggregate highest balance in all foreign financial accounts for the year in question did not exceed \$50,000, then the penalty for each violation is \$500 per violation not to exceed a total of \$5,000.⁴⁸ If the aggregate highest balance in all foreign financial accounts for the year in question exceeds \$50,000, but is less than \$250,000, then the penalty for each violation is the lesser of \$5,000 or 10 percent of the highest balance in the account during the year for which the account should have been reported.⁴⁹

occur in the course of violating certain other laws can result in fines up to \$500,000 or ten years imprisonment or both. *See id.* § 5322(b).

⁴² In other contexts, the courts have noted that Congress’s use of the word “may” evidences the intent to provide regulatory authorities with discretion. *See, e.g., McMullen v. United States*, 50 Fed. Cl. 718, 725 (2001).

⁴³ *See infra* note 83 and accompanying text.

⁴⁴ *See infra* note 83 and accompanying text.

⁴⁵ IRM 4.26.16.4 (July 1, 2008).

⁴⁶ IRM 4.26.16.4.6.1 (July 1, 2008).

⁴⁷ IRM 4.26.16.4.6.2 (July 1, 2008).

⁴⁸ *Id.*

⁴⁹ *Id.* There appears to be an error in the mitigation guidelines. The guidelines do not apply to a person who has an account whose highest balance is exactly \$250,000. It appears that the maximum

Penalties for non-willful violations of the reporting or record retention obligations may not be imposed if the failure at issue was due to reasonable cause and the transaction or the balance in the account was properly reported.⁵⁰ A literal reading of the statute appears to make the applicability of this exception highly unlikely for reporting violations. Because the reporting obligation is based on the existence of a foreign financial account, there is no “transaction” to report. Moreover, the federal income tax return merely requires a taxpayer to indicate whether the taxpayer has an interest in foreign accounts, but does not require the reporting of the balance in any such account.⁵¹ Consequently, if the non-willful violation is due to the failure to report, as opposed to the failure to maintain records, it seems impossible for a person to qualify for the exception regardless of whether such failure was due to reasonable cause. It is not clear how this exception will be interpreted. A sensible interpretation would require a reasonable cause for the failure to file the required report and the inclusion on the taxpayer’s income tax return of any taxable income from such accounts.⁵²

In addition to the exercise of discretion with respect to the assessment of penalties for non-willful violations, the IRS has also indicated that the exercise of discretion may be appropriate with respect to the imposition of willfulness penalties. According to the IRS, willfulness is shown by a person’s knowledge of, and conscious choice not to comply with, the foreign financial account reporting requirements.⁵³ Moreover, willful blindness—a conscious effort to avoid learning about the reporting requirement—by a person to the reporting obligation is grounds for the imposition of this penalty.⁵⁴ By way of examples, the IRS has indicated that the failure to answer a question regarding foreign financial accounts on an income tax return

penalty should be applied to accounts whose highest balance is \$250,000 or greater and not to those accounts whose highest balance exceeds \$250,000. Separate mitigation provisions apply to cases closed under the Last Chance Compliance Initiative. *See infra* note 71.

⁵⁰ *See supra* note 38.

⁵¹ *See supra* note 38.

⁵² What is reasonable cause for this purpose is not expressly defined. The IRS has indicated that the reasonable cause exceptions to the accuracy related penalties imposed by I.R.C. § 6662 may provide guidance. IRM 4.26.16.4.3.1 (July 1, 2008). These exceptions are couched in the rhetoric of reasonableness and it is questionable whether exceptions that are provided for the misapplication of technical tax provisions are of much use in this context. *See generally* Treas. Reg. § 1.6662-3 (2003). Most non-willful failures to report are due to, I venture to speculate, ignorance of the law. Although this may seem to be a plausible excuse, Schedule B of Form 1040 does inquire of the taxpayer whether she has an interest in a foreign account and references the reporting obligation. *See 2014 Form 1040, Schedule B, Part III, Foreign Accounts and Trusts*, INTERNAL REVENUE SERV. (Sept. 27, 2014), <http://www.irs.gov/pub/irs-pdf/f1040sb.pdf>. Perhaps a failure to timely file due to significant illness or other personal catastrophe, some unusual circumstance whereby the taxpayer had a reasonable basis to believe that an account was not a foreign financial account, or the fact that the taxpayer has mere signature authority over an account without any beneficial interest in such account may fall within this exception.

⁵³ IRM 4.26.16.4.5.3 (July 1, 2008).

⁵⁴ *Id.*

without a reasonable explanation, the failure to currently report after reports were filed in prior years, and the failure to heed a warning letter concerning the reporting obligation, warrant the imposition of the willfulness penalty.⁵⁵ A willfulness penalty is not imposed if the failure to report was due to reasonable cause.⁵⁶ Presumably, this exception should only apply to situations in which the person failing to report knew of the reporting obligation and had a reasonable basis for failing to report an account or accounts. For example, the failure to report certain accounts that were closed prior to the end of the year and income properly reported on an income tax return may not warrant a finding of willfulness.⁵⁷

Mitigation provisions are also applicable to willful violations. In order for these provisions to apply, the four requirements applicable to mitigation for non-willful violations must be met.⁵⁸ Mitigated penalty amounts are determined based on the balance of the account or accounts in question. Level I violations, those involving accounts whose maximum aggregate balance did not exceed \$50,000, are subject to a penalty of the greater of \$1,000 per violation or 5 percent of the maximum account balance for each unreported account during the calendar year.⁵⁹ A Level II violation, those not qualifying for Level I mitigation and that relate to an unreported account for which the maximum balance did not exceed \$250,000, are subject to a penalty of the greater of \$5,000 per violation or 10 percent of the maximum account balance for each unreported account during the calendar year.⁶⁰ Level III violations, those that relate to an unreported account for which the maximum balance exceeded \$250,000 but did not exceed \$1,000,000, are subject to a penalty of the greater of 10 percent of the maximum account balance for each unreported account during the calendar year or 50 percent of the closing balance in the account as of the last date for filing the required report.⁶¹ Level IV violations, those that relate to an unreported account for which the maximum balance exceeded \$1,000,000, are subject to the statutory penalty.⁶²

The application of the FBAR penalties, absent any mitigation, can result in multiple penalties against the same account and the rules can become a trap for the unwary. For example, assume that several unrelated individuals, all U.S. citizens, form an investment club and that the club maintains one reportable foreign financial account with a balance of \$100,000. Generally, investment clubs are partnerships for income tax purposes. As such,

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *See id.*

⁵⁸ IRM 4.26.16.4.6.3 (July 1, 2008). *See also supra* note 46 and accompanying text.

⁵⁹ IRM 4.26.16.4.6.3 (July 1, 2008).

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.* Separate mitigation provisions apply to cases closed under the Last Chance Compliance Initiative. *See infra* note 71.

the partnership itself has a reporting obligation.⁶³ In addition, any partner who holds a greater than 50 percent interest in the capital or profits of the partnership would also have a reporting obligation as well as any partner or other person with signature authority over the account.⁶⁴ Therefore, in the event that no member of the club held a greater than 50 percent interest in the capital or profits of the club, only the partnership and persons with signature authority on behalf of the partnership would be obligated to file the required report disclosing the foreign financial account.

However, Treasury regulations provide an election for certain investment partnerships to avoid partnership status.⁶⁵ In order to make such an election, the participants in the investment arrangement must reserve the right to separately dispose of their shares of the property and must not irrevocably authorize some person to act in a representative capacity to purchase, sell, or exchange investment property.⁶⁶ It is not clear whether an election out of partnership status would eliminate any entity reporting obligation and obligate all members of the club to file the required report. If the account is titled in the name of the club, then the reporting obligation would appear to belong to the club, but the regulations are not entirely clear on this point.⁶⁷ If not, and there were ten members of the club, then ten reports must be filed and, in a worst case scenario, the imposition of ten separate penalties could be imposed on the failure to report one account.⁶⁸ Most commonly, multiple filings with respect to one account are required for accounts over which signature authority is given by the beneficial owner to another person, such as a family member or agent, and are required for jointly held accounts. In the former case, the failure to file by the person with mere signature authority could very well avoid penalties because there would be no underreporting of income by such person with respect to the account.⁶⁹ The latter case, however, could very well result in the imposition of significant penalties on multiple persons over the failure to report the same account.

⁶³ See *supra* note 19 and accompanying text.

⁶⁴ See *supra* notes 17, 26, 31-32 and accompanying text.

⁶⁵ Treas. Reg. § 1.761-2(a)(1) (1994).

⁶⁶ *Id.* § 1.761-2(a)(2).

⁶⁷ Single member limited liability companies, absent an election to the contrary, are ignored for federal income tax purposes. See Treas. Reg. § 301.7701-3(a) (2006). However, the regulations do not ignore the existence of such limited liability companies despite the fact that they are ignored for income tax purposes. See 31 C.F.R. § 1010.350(b)(3) (2011).

⁶⁸ If the entity is ignored then all ten members would have a reporting obligation regardless of the manner in which the account is titled. Any member with signature authority over the account would be considered to be acting not only on her own behalf with respect to the account but also as an agent for the other members. See *supra* note 25 and accompanying text.

⁶⁹ See *supra* note 42 and accompanying text.

C. *Offshore Voluntary Disclosure Program*

On January 9, 2012, the IRS announced the institution of the Offshore Voluntary Disclosure Program (“OVDP”).⁷⁰ This program succeeded several other voluntary disclosure programs.⁷¹ OVDP is open for an indefinite period.⁷² The objective of the program is to encourage voluntary compliance by taxpayers with respect to the reporting of foreign assets and tax payments on the income derived from these assets.⁷³ Incentive comes in the form of reduced penalties and the possibility to avoid criminal prosecution. Taxpayers participating in the program must pay any income taxes owed, interest on tax deficiencies, certain income tax penalties on any underpayments of tax, and an offshore penalty in lieu of other penalties that may apply with respect to the nondisclosure of foreign assets.⁷⁴ The voluntary

⁷⁰ *IRS Offshore Programs Produce \$4.4 Billion to Date for Nation's Taxpayers; Offshore Voluntary Disclosure Program Reopens*, INTERNAL REVENUE SERV. (Jan. 9, 2012), [http://www.irs.gov/uac/IRS-Offshore-Programs-Produce-\\$4.4-Billion-To-Date-for-Nation%E2%80%99s-Taxpayers;-Offshore-Voluntary-Disclosure-Program-Reopens](http://www.irs.gov/uac/IRS-Offshore-Programs-Produce-$4.4-Billion-To-Date-for-Nation%E2%80%99s-Taxpayers;-Offshore-Voluntary-Disclosure-Program-Reopens).

⁷¹ The IRS instituted the Offshore Voluntary Disclosure Initiative in 2011. *See Second Special Voluntary Disclosure Initiative Opens; Those Hiding Assets Offshore Face Aug. 31 Deadline*, INTERNAL REVENUE SERV. (Feb. 8, 2011), <http://www.irs.gov/uac/Second-Special-Voluntary-Disclosure-Initiative-Opens%3B-Those-Hiding-Assets-Offshore-Face-Aug.-31-deadline>. Details of this program can be found on the IRS website. *See 2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, INTERNAL REVENUE SERV., <http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers> (last updated Mar. 19, 2014). This program succeeded the 2009 Offshore Voluntary Disclosure Program. *IRS Voluntary Disclosure Program*, INTERNAL REVENUE SERV., http://www.irs.gov/pub/newsroom/overview_en.pdf (last visited Oct. 21, 2014). The first voluntary disclosure initiative, the Offshore Voluntary Compliance Initiative, was initiated in 2003 to encourage the voluntary disclosure of unreported income. This program was initiated as a result of “John Doe” summons investigations beginning in 2000. Those who did not participate in this program were offered a limited amnesty, termed the Last Chance Compliance Initiative, through the issuance of certain “last chance” letters. *See* Rev. Proc. 2003-11, 2003-1 C.B. 311; I.R.S. Letter 3649 (Rev. 6-2003). These programs differ from each other and the 2012 program in their details. However, they share the same basic objective: the encouragement of voluntary disclosure in exchange for penalty relief, avoidance of criminal liability, and information regarding the activities of offshore financial institutions.

⁷² *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, INTERNAL REVENUE SERV., FAQ 1 (June 26, 2012), <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers> [hereinafter *OVDP FAQs*]. Taxpayers should obtain pre-clearance before disclosing information to the IRS. After the required information is submitted taxpayers will obtain a preliminary acceptance into the program. The procedural details of the program are discussed at *id.* at FAQs 22-30.

⁷³ *Id.* at FAQ 2.

⁷⁴ *Id.* at FAQ 7. Several Swiss banks, in an effort to curry favor with the Department of Justice, are providing incentives to their U.S. customers in an effort to encourage their voluntary disclosure of accounts. The incentives vary among banks but often include an offer to reimburse their clients for a portion of their legal and accounting fees incident to the process of voluntary disclosure. *See* John Letzing, *Taxpayers Get Incentives to Report*, WALL ST. J., July 19, 2014, at B1 (east ed.).

disclosure period consists of the most recent eight years for which the due date of the return has already passed.⁷⁵ A taxpayer must make timely, truthful, and complete disclosures and cooperate with the IRS in its determination of the taxpayer's correct tax liability.⁷⁶ Disclosure is not timely if it is made after the taxpayer is under examination or under criminal investigation.⁷⁷ Moreover, a participating taxpayer must cooperate with IRS offshore enforcement efforts by providing, if requested, information about offshore financial institutions, offshore service providers, and other facilitators, and notify the Department of Justice ("DOJ") if the taxpayer has appealed a foreign tax official's decision that authorizes the provision of account information to the IRS.⁷⁸

The offshore penalty is 27.5 percent of all foreign assets that relate to tax noncompliance.⁷⁹ This penalty applies to a broader class of assets than foreign financial accounts that are subject to the statutory penalties discussed above. For example, this penalty would apply to foreign-based real estate if the real estate was acquired with assets for which U.S. taxes were owed but not paid, or if the real estate generates income for which tax was due but not paid.⁸⁰ The penalty is imposed at a rate of 12.5 percent if the aggregate amount of assets in each year covered by the program is less than \$75,000.⁸¹ A 5-percent penalty is applied in certain limited circumstances—generally in cases where the account in question was not opened by the taxpayer, minimal withdrawals were made from the account, and the taxpayer had minimal and infrequent contact with the account.⁸²

If a taxpayer is compliant with the requirements of the program, then the IRS will not recommend criminal prosecution of the taxpayer to the DOJ.⁸³ Taxpayers who make so-called "quiet" disclosures by filing amended tax returns and paying any tax, interest, and penalties due are not assured of the avoidance of criminal prosecution.⁸⁴ Moreover, such "quiet disclosures" do not avoid penalties for FBAR reporting failures. Hence, if a tax-

⁷⁵ *OVPD FAQs*, *supra* note 72, at FAQ 9.

⁷⁶ *Id.* at FAQs 7, 7.1.

⁷⁷ *Id.* at FAQ 14.

⁷⁸ *Id.* at FAQs 7, 21. Such notice is required pursuant to 18 U.S.C. § 3506.

⁷⁹ *OVDP FAQs*, *supra* note 72, at FAQ 8. Examiners are provided no discretion to reduce the penalty under this program. Because the penalty is applicable to a broader class of assets than the statutory penalty and because the penalties that may be imposed outside this program are subject to discretion and mitigation it is very possible that the penalties owed under the program exceed the penalties that would have been otherwise imposed. In such cases, the lesser penalty amount will be imposed. *Id.* at FAQ 50.

⁸⁰ *Id.* at FAQ 35.

⁸¹ *Id.* at FAQ 53.

⁸² *Id.* at FAQ 52. This reduced penalty also applies to certain foreign residents who were unaware they were U.S. citizens and other foreign residents that meet specific requirements. *See id.*

⁸³ *OVDP FAQs*, *supra* note 72, at FAQ 3.

⁸⁴ *Id.* at FAQ 15.

payer desires to take advantage of both the penalty structure of the OVDP and the greater certainty that the OVDP provides with respect to the avoidance of criminal prosecution, then “quiet disclosures” should cede to voluntary disclosure under the program.

Taxpayers who have reported, and paid tax on, all of their taxable income from unreported accounts and have not been notified that they are under examination should not participate in the program because no penalty will be imposed if such taxpayers simply file late FBAR reports.⁸⁵ Taxpayers who have not reported and paid tax on taxable income from foreign accounts must consider the effect that the eight-year participation period for the OVDP has on their potential exposure. This period is considerably longer than the standard statute of limitations period for the assessment of income taxes and the six-year statute of limitations period for FBAR filings.⁸⁶ In addition, such taxpayers must consider the effect that the mitigation provisions, if applicable, would have on their potential exposure, notwithstanding the OVDP.⁸⁷ Of course, the potential for criminal prosecution may overwhelm these other factors. Fortunately, the OVDP allows taxpayers to opt out of the program.⁸⁸ Under appropriate circumstances, the decision to opt out will allow taxpayers to avoid overly harsh penalties that would be imposed under the OVDP yet avoid criminal prosecution.⁸⁹

As of July 1, 2014, modifications to the OVDP have gone into effect. The modified program is a continuation of the 2012 OVDP, but, for purposes of this Article, the modified program is referred to as the 2014 OVDP.⁹⁰ Among the significant modifications to the program is the imposition of a 50 percent penalty if either a foreign financial institution at which the taxpayer has or had an account or a facilitator who helped the taxpayer establish or maintain an offshore arrangement has been publicly identified

⁸⁵ *Id.* at FAQ 17.

⁸⁶ *See supra* note 39. In general, tax may be assessed within three years of the due date of tax return of the date on which such return was filed, whichever is later. I.R.C. § 6501(a) (2012). If a taxpayer has omitted a substantial amount of gross income, as statutorily defined, then income tax may be assessed within six years of the due date of the return or the date on which such return was filed, whichever is later. *Id.* § 6501(e)(1). In the case a taxpayer files a false or fraudulent return with the intent to evade tax or willfully attempts, in any manner, to defeat or evade tax, or fails to file a return then tax may be assessed at any time. *Id.* § 6501(c)(1)-(3). Taxpayers may agree to extend the statute of limitations for assessment or collection of tax. *Id.* § 6501(c)(4). Taxpayers must agree to the extension of the statute of limitations to participate in the OVDP. *OVDP FAQs, supra* note 72, at FAQ 42.

⁸⁷ *See supra* notes 44-60 and accompanying text.

⁸⁸ *OVDP FAQs, supra* note 72, at FAQ 51.

⁸⁹ *Id.* at FAQ 51.1.

⁹⁰ A taxpayer who submitted an application to participate in the 2012 OVDP prior to July 1, 2012 and whose case is unresolved may elect to participate in the 2014 OVDP. *See Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, INTERNAL REVENUE SERV., FAQ 1.3, <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised> (last updated Sept. 10, 2014) [hereinafter *2014 OVDP FAQs*].

as being under investigation or as cooperating with a government investigation, and the requirement that penalties be paid at the time of application to the program.⁹¹ Moreover, the reduced penalties available under certain circumstances have been eliminated due to the expansion of the streamlined filing compliance procedures.⁹² Prior to the revisions, U.S. citizens residing abroad who were deemed low compliance risks could submit their information under a streamlined process and would not be assessed penalties.⁹³ To be eligible for this program, the foreign resident's tax liability for any of the years at issue must be less than \$1,500.⁹⁴ The IRS has expanded the streamlined filing procedures to U.S.-based taxpayers who certify that their failure to file was due to non-willful conduct—conduct that is not due to negligence, inadvertence, or mistake, or conduct that is the result of a good-faith misunderstanding of the requirements of the law.⁹⁵ Moreover, the limitation on the amount of delinquent tax has been eliminated. Penalties under this program—termed the Streamlined Domestic Offshore Procedures—are limited to 5 percent of the taxpayer's highest aggregate account balances.⁹⁶ The modifications provide welcome relief to taxpayers who have failed to report non-willfully, but increase the pressure on willful non-compliers to come clean. The U.S. government's aggressive actions against foreign fi-

⁹¹ *Id.* at FAQ 7.2. This provision is effective on August 4, 2014. *Id.* Despite the higher penalty rate this penalty is preferable to the maximum statutory penalty which is imposed on a taxpayer each year that there is reporting failure.

⁹² *Id.* at FAQ 1.3. See *supra* notes 70-89 and accompanying text for a discussion of the reduced penalties under the 2012 OVDP.

⁹³ *New Filing Compliance Procedures for Non-Resident U.S. Taxpayers*, INTERNAL REVENUE SERV., <http://www.irs.gov/Individuals/International-Taxpayers/New-Filing-Compliance-Procedures-for-Non-Resident-U.S.-Taxpayers> (last updated Aug. 8, 2014).

⁹⁴ *Id.*

⁹⁵ *U.S. Taxpayers Residing in the United States*, INTERNAL REVENUE SERV., <http://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-in-the-United-States> (last updated Aug. 19, 2014). Convincing the IRS that a failure to file was non-willful could be difficult for taxpayers with substantial balances in foreign financial accounts. "In the real world, the biggest factor determining willfulness is the size of the account." Laura Saunders, *Offshore Disclosure Comes with Hazards*, WALL ST. J., June 28, 2014, at B8 (east ed.) (quoting Edward Robbins, criminal tax attorney, Hochman, Salkin, Rettig, Toscher & Perez, P.C.) (internal quotation marks omitted).

⁹⁶ *U.S. Taxpayers Residing in the United States*, *supra* note 95. Once a taxpayer makes a submission under this program she may not participate in OVDP. Similarly, a taxpayer who submits, or has submitted, an OVDP voluntary disclosure letter on or after July 1, 2014 is not eligible to participate in the streamlined procedures. A taxpayer eligible for treatment under the streamlined procedures who submits, or has submitted, a voluntary disclosure letter under the OVDP or any predecessor program prior to July 1, 2014 but has yet to execute a closing agreement may request treatment under the applicable penalty terms available under the streamlined procedures. See *Streamlined Filing Compliance Procedures*, INTERNAL REVENUE SERV., <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures> (last updated Aug. 19, 2014). Similar terms and procedures are available to U.S. citizens residing in foreign jurisdictions. See generally *U.S. Taxpayers Residing Outside the United States*, INTERNAL REVENUE SERV., <http://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-Outside-the-United-State> (last updated Aug. 29, 2014).

financial institutions may result in a taxpayer's inability to qualify for the 27.5-percent penalty if the taxpayer's foreign financial institution is publicly identified as a party under investigation or as a cooperative party.⁹⁷ By the time that such a taxpayer reads about an investigation of her financial institution in the *New York Times*, the ability to obtain a reduced penalty under the OVDP has passed.

D. *Related Provisions*

1. FATCA

Recent legislation has put a reporting regime in effect that complements, but differs in several respects from, the FBAR requirements.⁹⁸ FATCA was enacted as part of Title V of the Hiring Incentives to Restore Employment Act.⁹⁹ This legislation mandates that foreign financial institutions provide certain information to U.S. tax authorities or face tax withholding on income that the institutions derive from sources within the United States.¹⁰⁰ In addition, FATCA added section 6038D to the Internal Revenue Code ("I.R.C.") that, effective for taxable years beginning after March 18, 2010, imposes an annual foreign asset reporting requirement on individuals and specified domestic entities.¹⁰¹ This reporting requirement is met

⁹⁷ Robert W. Wood, *IRS Increases Offshore 'Amnesty' Penalty From 27.5% to 50%, Makes Other Changes*, FORBES (June 18, 2014), <http://www.forbes.com/sites/robertwood/2014/06/18/irs-increases-offshore-amnesty-penalty-from-27-5-to-50-makes-other-changes/>.

⁹⁸ The FBAR rules have their genesis in the banking law and, therefore, the IRS is bound by statutory confidentiality rules from using tax return information in its enforcement of the FBAR rules. In the aftermath of the revelations that the Nixon administration enlisted the IRS to further its political goals, tax returns and tax return information were made confidential. *See* I.R.C. § 6103(a) (2012). The president had access to tax return information by executive order or through regulations approved by the president until amendments were made to § 6103 by the Tax Reform Act of 1976, Pub. L. No. 94-455, § 1202, 90 Stat. 1520, 1667-88 (1976). This legislation provided that, with certain, very narrow exceptions, no officer or employee of the United States, among other persons, may disclose any return or return information unless specifically authorized by the statute. I.R.C. § 6103(a)(1), (d), (f), (g)(1)-(2), (j). Willful unauthorized disclosures are punishable by fines, incarceration, and dismissal from office. I.R.C. § 7213(a). Civil actions against the United States may also be brought for knowing or negligent unauthorized disclosures. I.R.C. § 7431(a)(1). The FATCA reporting obligation is mandated under the Internal Revenue Code and, therefore, no such restrictions apply to the IRS in its enforcement of these rules. *See* TREAS. INSPECTOR GEN. FOR TAX ADMIN., 2010-30-125, NEW LEGISLATION COULD AFFECT FILERS OF THE REPORT OF FOREIGN BANK AND FINANCIAL ACCOUNTS, BUT POTENTIAL ISSUES ARE BEING ADDRESSED 8 (2010), available at <http://www.treasury.gov/tigta/auditreports/2010reports/201030125fr.pdf>.

⁹⁹ Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010).

¹⁰⁰ *See supra* notes 15-17 and accompanying text.

¹⁰¹ Hiring Incentives to Restore Employment Act, Pub. L. No. 111-47, § 511(a), 124 Stat. 71, 109 (codified at I.R.C. § 6038D (2012)). Temporary regulations issued in 2011 reserved guidance on the

by the filing of Form 8938 with the taxpayer's income tax return.¹⁰² Unlike the FBAR rules, FATCA reporting obligations are imposed only upon individuals and specified domestic institutions.¹⁰³

Taxpayers are required to file Form 8938 for any tax year in which the aggregate value of their interests in specified foreign financial assets either exceeds \$50,000 on the last day of the tax year or exceeds \$75,000 at any time during the tax year.¹⁰⁴ These threshold amounts are doubled for married taxpayers that file a joint return.¹⁰⁵ In contrast to the FBAR regulations, an interest in a specified financial account exists if any income, gain, loss, deduction, credits, gross proceeds or distributions attributable to accounts that are, or would be, required to be reported or otherwise reflected by the taxpayer on his tax return.¹⁰⁶ The fact that the specified financial assets have no effect on a taxpayer's tax liability is not relevant to the determination of whether a reporting obligation exists.¹⁰⁷ Unlike the FBAR rules, record

reporting by specified domestic entities. Temp. Treas. Reg. § 1.6038D-6T (2011). However, regulations were proposed in 2011 that did define a specified domestic entity for this purpose. In general, under the proposed regulations, domestic corporations or partnerships that are closely held by a specified individual, have an interest in specified foreign financial assets in excess of the reporting threshold described above, and meet a 50 percent passive income or asset test are specified domestic entities. *See* Prop. Treas. Reg. § 1.6038D-6(b)(1)(i)-(iii)(A), 76 Fed. Reg. 78,594, 78,597 (Dec. 19, 2011). A corporation is closely held if at least 80 percent of the total combined voting power of all classes of stock of the corporation are entitled to vote, or at least 80 percent of the total value of the stock of the corporation is owned directly, indirectly, or constructively by one specified individual on the last day of the corporation's taxable year. Prop. Treas. Reg. § 1.6038D-6(b)(3)(i), 76 Fed. Reg. at 78,597. A partnership is closely held if at least 80 percent of the profits or capital interests in the partnership are held directly, indirectly, or constructively by one specified individual on the last day of the partnership's taxable year. Prop. Treas. Reg. § 1.6038D-6(b)(3)(ii), 76 Fed. Reg. at 78,597. The 50 percent passive gross income or asset test is replaced with a 10 percent passive gross income or asset test if the entity was formed with a principal purpose of avoiding the reporting obligations. Prop. Treas. Reg. § 1.6038D-6(b)(1)(iii)(B), 76 Fed. Reg. at 78,597. A domestic trust is considered a specified domestic entity if it has an interest in specified foreign financial assets with an aggregate value exceeding the reporting threshold described above and has one or more specified persons as current beneficiaries. Prop. Treas. Reg. § 1.6038D-6(c), 76 Fed. Reg. at 78,598-99. For this purpose, a current beneficiary is any person who, during the taxable year, is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust. Prop. Treas. Reg. § 1.6038D-6(c)(2), 76 Fed. Reg. at 78,599. The IRS has stated that domestic entities will not be required to report until the regulations are finalized. *See* I.R.S. Notice 2013-10, 2013-8 I.R.B. 503.

¹⁰² Temp. Treas. Reg. § 1.6038D-2T(a)(7) (2012).

¹⁰³ I.R.C. § 6038D(a), (f) (2012). *See supra* notes 17-23 and accompanying text for a discussion of persons subject to the FRAR reporting requirements.

¹⁰⁴ I.R.C. § 6038D(a); Temp. Treas. Reg. § 1.6038D-2T(a)(1) (2012).

¹⁰⁵ Temp. Treas. Reg. § 1.6038D-2T(a)(2). If the IRS determines that an individual has an interest in one or more specified foreign financial accounts and fails to provide sufficient information to demonstrate the aggregate value of such accounts then the aggregate value of such accounts is presumed to exceed the reporting thresholds. I.R.C. § 6038D(e).

¹⁰⁶ Temp. Treas. Reg. § 1.6038D-2T(b)(1).

¹⁰⁷ *Id.*

ownership, legal title, or signature authority is not determinative of whether a taxpayer has an interest in an account.¹⁰⁸

Specified financial accounts are financial accounts maintained by a foreign financial institution, stocks or securities issued by a person other than a U.S. person, financial contracts or instruments whose issuer or counterparty is other than a U.S. person—for example, derivative contracts—and an interest in a foreign entity.¹⁰⁹ Although there is significant overlap between these reporting requirements and the FBAR rules, there are significant differences between the two reporting schemes with respect to assets subject to disclosure. For example, financial accounts over which a person has signature authority, but no beneficial ownership, and financial accounts held in a foreign branch of a U.S. financial institution are subject to FBAR reporting, but not subject to the FATCA rules.¹¹⁰ Stocks of foreign issuers not held in a foreign financial account, interests in foreign hedge funds, and interests in foreign partnerships are not subject to FBAR disclosure, but are required to be reported pursuant to FATCA.¹¹¹

The penalty for failure to meet the FATCA reporting obligation with respect to any taxable year is \$10,000.¹¹² Additional penalties are imposed if the failure to report continues for more than ninety days after notification of such failure by the IRS.¹¹³ The additional penalties are \$10,000 per month for failure to report after the expiration of the ninety-day period described above, limited to a maximum additional penalty amount of \$50,000.¹¹⁴ This penalty, unlike the FBAR penalties, is not account-based.¹¹⁵ No penalty may be imposed if the failure to report is due to reasonable cause and not to willful neglect.¹¹⁶ The fact that a FATCA disclosure would subject a person to the imposition of civil or criminal sanctions by a foreign jurisdiction is not reasonable cause for failing to report.¹¹⁷

2. General Tax Penalties

In addition to the penalties imposed for failing to file the required reports described above, a host of penalties may be imposed upon taxpayers who fail to report and pay tax on taxable income derived from foreign financial accounts. Taxpayers are subject to a penalty of 40 percent of the

¹⁰⁸ See *supra* notes 25-33 and accompanying text.

¹⁰⁹ I.R.C. § 6038D(b).

¹¹⁰ See *supra* notes 30-33 and accompanying text.

¹¹¹ See *supra* notes 20-23 and accompanying text.

¹¹² I.R.C. § 6038D(d)(1).

¹¹³ *Id.* § 6038D(d)(2).

¹¹⁴ *Id.*

¹¹⁵ See *supra* notes 39-41 and accompanying text.

¹¹⁶ I.R.C. § 6038D(g).

¹¹⁷ *Id.*

amount of any underpayment of tax attributable to any transaction involving an undisclosed foreign financial asset.¹¹⁸ For this purpose, an undisclosed foreign financial asset includes an asset that was required to be reported under the FATCA rules described above but was not so reported.¹¹⁹ Moreover, any underpayment of tax due to fraud is subject to a penalty equal to 75 percent of the underpayment that is attributable to fraud.¹²⁰

Various criminal sanctions set forth in the I.R.C. may also be imposed.¹²¹ These sanctions are in addition to the criminal sanctions that may be imposed under Title 31 for violations of the FBAR rules.¹²² Willful attempts to evade or defeat the imposition or payment of any tax is a felony punishable by a fine of not more than \$100,000, imprisonment for not more than five years, or both.¹²³ The willful failure to adhere to any requirement to keep records or supply information is a misdemeanor punishable by a fine of not more than \$25,000, imprisonment for not more than one year, or both.¹²⁴ The making of fraudulent statements, concealment of property, or the withholding, falsification, or destruction of records is a felony that is subject to a fine of not more than \$100,000, imprisonment for not more than three years, or both.¹²⁵ Finally, the willful filing of a fraudulent or false return is subject to a fine of not more than \$10,000, imprisonment for not more than one year, or both.¹²⁶

¹¹⁸ I.R.C. § 6662(b)(7), (j). If the taxpayer failed to report a substantial amount of gross income, as defined, on her return then the statute of limitations for assessment of tax is extended from three years to six years. *See id.* § 6501(e)(1)(A).

¹¹⁹ I.R.C. § 6662(j)(2).

¹²⁰ *Id.* § 6663(a). If any portion of the underpayment is attributable to fraud it is presumed that the entire underpayment is so attributable and the burden of proof shift to the taxpayer to prove by a preponderance of the evidence the amount of the underpayment of tax not so attributable. *Id.* § 6663(b). There is no statute of limitations on the assessment of tax if the underpayment of tax is due to fraud. *See supra* note 86.

¹²¹ In general, the statute of limitations for the prosecution of a criminal offense arising under the internal revenue laws is three years after the commission of the offense. I.R.C. § 6531. However, for various offenses, including several relevant here, the statute of limitations is six years after the commission of the offense. *See id.*

¹²² Criminal penalties of up to \$250,000 in fines and imprisonment for no more than five years may be imposed under Title 31. *See* 31 U.S.C. § 5322(a) (2012). Violations of the reporting requirements that occur in the course of violating certain other laws can result in fines up to \$500,000 or 10 years imprisonment or both. *Id.* § 5322(b).

¹²³ I.R.C. § 7201.

¹²⁴ *Id.* § 7203.

¹²⁵ *Id.* § 7206.

¹²⁶ *Id.* § 7207.

E. *Example*

The following example illustrates the extent of the penalties that may be imposed on persons that fail to report foreign financial accounts. Assume that John Jones, a U.S. citizen, opened a foreign financial account with a \$10,000,000 deposit at the beginning of 2009. The funds used to open the account were not derived from illegal activities and all taxable income has been duly reported by John Jones up to this point. The account earned a return of 6 percent per annum, compounded annually, and no income taxes were withheld or otherwise imposed by the foreign jurisdiction on the earnings generated by the account.¹²⁷ The earnings were reinvested in the account and the account remained open through the end of 2013. No additions, other than reinvested income, or withdrawals were made from the account between 2009 and 2013. John Jones willfully and fraudulently failed to report the foreign account pursuant to the FBAR rules and also willfully and fraudulently failed to report the taxable income generated from the account on his income tax returns. The balance in the account at the end of each year and the taxable income generated from the account for each year were as follows:

Taxable Year	Taxable Income ¹²⁸	Ending Account Balance ¹²⁹
2009	\$600,000	\$10,600,000
2010	\$636,000	\$11,236,000
2011	\$674,160	\$11,910,160
2012	\$714,610	\$12,624,770
2013	\$757,486	\$13,382,256

The income tax and penalties due for the years 2009 and 2013 inclusive are as follows:

¹²⁷ Foreign taxes paid would be creditable, in whole or in part, by a U.S. citizen against that individual's U.S. income tax liability. *See generally id.* §§ 901-09. Therefore, any tax liability due to the United States would be reduced by the amount of the foreign tax credit to which the individual would be entitled. A discussion of the foreign tax credit is beyond the scope of this work.

¹²⁸ Taxable income for each year equals the product of the account balance at the end of the preceding year and .06.

¹²⁹ The ending account balance for each year equals the sum of account balance at the end of the preceding year and the taxable income for the current year.

Taxable Year	Income Tax Due ¹³⁰	§6662 Understatement Penalty ¹³¹	§6663 Fraud Penalty ¹³²	FATCA Penalty ¹³³	FBAR Penalty ¹³⁴
2009	\$210,000	\$42,000	\$157,500	N/A	\$5,300,000
2010	\$222,600	\$44,520	\$166,950	N/A	\$5,618,000
2011	\$235,956	\$94,382	\$176,967	\$10,000	\$5,955,080
2012	\$250,114	\$100,046	\$187,586	\$10,000	\$6,312,385
2013	<u>\$328,749</u>	<u>\$131,500</u>	<u>\$246,562</u>	<u>\$10,000</u>	<u>\$6,691,128</u>
Total	\$1,247,419	\$412,448	\$935,565	\$30,000	\$29,876,593

The taxpayer also would be liable for interest on the tax deficiencies, possible criminal fines for a variety of offenses, and perhaps face imprisonment.¹³⁵ Had the taxpayer been accepted in the OVDP program and complied with its requirements, he would owe the tax, any interest on the tax, and the \$412,448 in understatement penalties, but would owe no civil fraud, or FATCA or FBAR penalties. In lieu of these penalties, an offshore penal-

¹³⁰ Income tax due was determined under the assumption that the taxpayer owes tax at the highest marginal tax rate in effect for the year in question. The highest marginal tax rate for the years 2009 through 2012 was 35 percent. In 2013, that rate was 39.6 percent. *See* American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 101(b), 126 Stat. 2313, 2316 (2013) (codified at I.R.C. § 1 (2012)). The Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1402(a)(1), 124 Stat. 1029, 1060-63 (codified at I.R.C. § 1411 (2012)) introduced an Unearned Income Medicare Contribution that, effective in taxable years beginning in 2013, imposes a 3.8 percent surtax on individuals, estates, and trusts. For individuals, the tax base on which the surtax is imposed is the lesser of net investment income or the excess of modified adjusted gross income over a threshold amount. *See* I.R.C. § 1411(a)(1), (b). Consequently, the marginal tax rate used for 2013 in this example is 43.4 percent, the sum of the 39.6 marginal income tax rate and the 3.8 percent Unearned Income Medicare Contribution.

¹³¹ *See supra* notes 118-19 and accompanying text. The penalty for understatement of tax was 20 percent of the amount of the understatement. However, effective for tax years beginning after March 18, 2010, the understatement penalty is 40 percent for understatements of tax due attributable to undisclosed foreign financial accounts. *See* Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 512(a)(2), 124 Stat. 71, 110-11 (2010) (codified at I.R.C. § 6662(j) (2012)).

¹³² The civil fraud penalty is 75 percent of the underpayment of tax attributable to fraud. *See* I.R.C. § 6663(a).

¹³³ The FATCA penalty became effective in taxable years beginning after March 18, 2010. *See supra* note 98 and accompanying text.

¹³⁴ This example assumes that the statutory penalty for willful failure to file is imposed, that the mitigation provisions are not applicable, and that the taxpayer did not enter the OVDP. *See supra* notes 56-60, 68-94 and accompanying text for a discussion of the mitigation provisions and the OVDP. The statutory penalty for willful failure to file the required report is 50 percent of the account balance. *See supra* note 39 and accompanying text. For purposes of this example, the account balance used to determine the penalty is the balance in the account at the end of the applicable reporting year.

¹³⁵ Interest also may be imposed on the penalties in certain circumstances. *See generally* I.R.C. § 6601(a), (e)(2). *See supra* notes 121-26 and accompanying text for a discussion of the criminal penalties that may be applicable.

ty of \$3,680,120 would be imposed.¹³⁶ Moreover, criminal sanctions likely would be avoided.

A case is currently making its way through the courts that may test the constitutionality of maximum FBAR penalties. In *United States v. Zwerner*,¹³⁷ a jury recently returned a verdict upholding three years of maximum penalties imposed on a taxpayer.¹³⁸ The defendant is challenging the constitutionality of the fines on Eighth Amendment grounds.¹³⁹ This is the first case to test the constitutionality of the FBAR regime. As discussed in Part II, guidance with respect to the Excessive Fines Clause of the Eighth Amendment is sparse. Moreover, the Court's precedents do not yield a clear answer with respect to whether maximum FBAR penalties violate the Eighth Amendment. A factor that should be given significant weight by the courts in their determination of whether such penalties are constitutionally infirm is the existence of harsh penalties for tax evasion. These penalties provide evidence that the maximum FBAR penalties are, in many cases, excessive.

II. EIGHTH AMENDMENT: EXCESSIVE FINES CLAUSE

The Eighth Amendment states that “[e]xcessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted.”¹⁴⁰ There is a dearth of precedent from the Court by which the trigger point for the invocation of the Excessive Fines Clause can be determined with any precision. However, the Court has made clear that the prohibition on the imposition of excessive fines extends beyond criminal punishments. Moreover, the Court has subjected *in rem* forfeitures to the strictures of the Eighth Amendment, thus leaving no doubt that the prototypical monetary fine, such as that imposed under the FBAR rules, is subject to Eighth Amendment scrutiny.

¹³⁶ Under the OVDP program, the penalty imposed is 27.5 percent of the highest aggregate balance in the account for the years in question. This penalty is in lieu of all other penalties other than those noted. *See supra* note 79 and accompanying text.

¹³⁷ *United States v. Zwerner*, No. 1:13-cv-22082-CMA (S.D. Fla. filed June 11, 2013).

¹³⁸ *See* Press Release, Dep't of Justice, Jury Finds Miami Man Owes Civil Penalties for Failing to Report Swiss Bank Account (May 28, 2014), <http://www.justice.gov/tax/2014/txdv14575.htm>. *See also* Verdict Form and Special Interrogatories at 2, *United States v. Zwerner*, No. 1:13-cv-22082-CMA (S.D. Fla. filed June 11, 2013), *available at* <https://docs.google.com/file/d/0B0SLTNWD-Z3YYzhpUC05cm5OVDA/edit?pli=1>.

¹³⁹ Taxlitigator.com, *Zwerner: Jury Determines 150% FBAR Penalty Applies—Excessive Fines Clause to the Rescue??*, TAX CONTROVERSY (CIV. & CRIM.) REP. (May 29, 2014), <http://taxlitigator.me/2014/05/29/zwerner-jury-determines-150-fbar-penalty-applies-excessive-fines-clause-to-the-rescue/>.

¹⁴⁰ U.S. CONST. amend. VIII.

In *Browning-Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc.*,¹⁴¹ the Court had occasion to determine whether the Excessive Fines Clause served as a check on jury awards in civil cases. The respondents, a former manager of Browning-Ferris and a corporation that he founded, alleged, in a federal district court, that Browning-Ferris's actions in response to the respondents' successful foray in the waste disposal business constituted violations of the Sherman Antitrust Act and were tortious under state law.¹⁴² A jury awarded Kelco \$51,146 in compensatory damages and \$6 million in punitive damages.¹⁴³ The district court then awarded Kelco treble damages and attorney fees on the antitrust claim or, in the alternative, slightly more than \$6 million in punitive damages on the state law tort claim.¹⁴⁴ The Second Circuit affirmed, noting that the applicability of the Eighth Amendment in this case would have no effect on its decision because the damages that were awarded were not cruel, unusual, or constitutionally excessive.¹⁴⁵

The Court, citing two nineteenth century precedents and one relatively recent case, stated that the Excessive Fines Clause has been understood "to apply primarily, and perhaps exclusively, to criminal prosecutions and punishments."¹⁴⁶ However, in this case, the Court expressly refused to narrow the confines of the Excessive Fines Clause to criminal punishments.¹⁴⁷ Instead, the Court, relying on the historical record, held that the Eighth Amendment "clearly was adopted with the particular intent of placing limits on the powers of the new Government."¹⁴⁸ The petitioners asserted that the scope of the Eighth Amendment should be informed by the fact that the Magna Carta had, as one of its objectives, the placement of limits on the use of amercements, a remedy analogous to modern day punitive damages.¹⁴⁹ The Court found the petitioners' analogy inapposite primarily because such amercements were paid directly to the Crown.¹⁵⁰

¹⁴¹ 492 U.S. 257 (1989).

¹⁴² *Id.* at 260-61.

¹⁴³ *Id.* at 262.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* at 262-63 (citing *Ingraham v. Wright*, 430 U.S. 651, 664-68 (1977); *Fong Yue Ting v. United States*, 149 U.S. 698, 730 (1893); *Ex parte Watkins*, 32 U.S. 568, 573-74 (1833)). The Court noted that *Ingraham* left open the possibility that the Cruel and Unusual Punishments Clause of the Eighth Amendment could apply in civil confinement cases and that the Amendment's prohibition of excessive bail may be implicated in civil deportation proceedings. *Kelco*, 492 U.S. at 263 n.3. In any event, these potentialities were not relevant to the case at hand.

¹⁴⁷ *Kelco*, 492 U.S. at 265.

¹⁴⁸ *Id.* at 266. The Court referred to the Declaration of Rights or Constitutions of eight of the ratifying states, the Virginia Declaration of Rights, the English Bill of Rights of 1689, and the Magna Carta. *See id.* at 264-69.

¹⁴⁹ *Id.* at 268.

¹⁵⁰ *Id.* at 269. The dissent had an entirely different interpretation of the historical record. *See id.* at 286-98 (O'Connor, J., dissenting).

Despite the fact that the Court found it unnecessary to address the issue of whether the Excessive Fines Clause applied only in criminal cases, it intimated that such a narrow application of the clause may be unwarranted.¹⁵¹ Although the Court believed that the framers of the Eighth Amendment did not intend it to apply to awards by civil juries, the Court stated that “[o]ur Eighth Amendment jurisprudence has not been inflexible. . . . ‘Therefore a principle to be vital must be capable of wider application than the mischief which gave it birth.’”¹⁵² Moreover,

[w]e think it clear, from both the language of the Excessive Fines Clause and the nature of our constitutional framework, that the Eighth Amendment places limits on the steps a government may take against an individual, whether it be keeping him in prison, imposing excessive monetary sanctions, or using cruel and unusual punishments. . . . Here the government of Vermont has not taken a positive step to punish, as it most obviously does in the criminal context, *nor has it used the civil courts to extract large payments or forfeitures for the purpose of raising revenue or disabling some individual.*¹⁵³

Four years after *Browning-Ferris*, the Court had before it two cases that involved the scope of the Excessive Fines Clause, and its intimations in *Browning-Ferris* were made explicit.¹⁵⁴ The issue before the Court in *Austin v. United States*¹⁵⁵ was whether the Eighth Amendment applied to *in rem* civil forfeitures authorized by federal narcotics laws.¹⁵⁶ The petitioner was indicted on multiple counts of violating South Dakota’s drug laws.¹⁵⁷ State law enforcement authorities executed a search warrant and confiscated small amounts of marijuana and cocaine, less than \$5,000 in cash, some drug paraphernalia, and a handgun.¹⁵⁸ The United States filed an *in rem* action in federal district court that sought the forfeiture of the petitioner’s mobile home and auto body shop.¹⁵⁹ The petitioner asserted that the forfeiture sought violated the Excessive Fines Clause. The district court disagreed and entered summary judgment for the United States and the Eighth

¹⁵¹ *Id.* at 273 (majority opinion).

¹⁵² *Id.* (quoting *Weems v. United States*, 217 U.S. 349, 373 (1910)).

¹⁵³ *Kelco*, 492 U.S. at 275 (emphasis added).

¹⁵⁴ See *Austin v. United States*, 509 U.S. 602, 606-11 (1993); *Alexander v. United States*, 509 U.S. 544, 558-59 (1993).

¹⁵⁵ 509 U.S. 602 (1993).

¹⁵⁶ *Id.* at 606.

¹⁵⁷ *Id.* at 604.

¹⁵⁸ *Id.* at 605.

¹⁵⁹ *Id.* at 604-05. The forfeiture was sought pursuant to 21 U.S.C. §§ 881(a)(4) and 881(a)(7). These provisions subject to forfeiture all conveyances which are used, or intended for use, to transport or to facilitate the transport, “sale, receipt, possession, or concealment of controlled substances, their raw material, and equipment used in their manufacture and distribution” and any real property used, or intended to be used to commit or facilitate the commission of a violation of federal drug laws. *Id.* at 605 n.1.

Circuit affirmed the judgment.¹⁶⁰ Despite the Eighth Circuit's belief that the penalty imposed upon the petitioner was disproportionate to the offense committed, the court held that *in rem* forfeitures are not subject to proportionality constraints.¹⁶¹ According to the court, because Supreme Court precedent provides that innocent property owners may be subject to *in rem* forfeitures without constitutional objection, proportionality is not a constitutional limitation on the imposition of *in rem* civil forfeitures.¹⁶²

The Court rejected the government's contention that the Eighth Amendment applies only to criminal proceedings or to those civil proceedings that seek sanctions that are so punitive that they must be considered criminal under Court precedent.¹⁶³ Relying on the text of the Eighth Amendment and contrasting its text with the text of the Fifth and Sixth Amendments, the Court held that the application of the Eighth Amendment is not confined to criminal cases.¹⁶⁴ Likewise, its history supports no such limitation.¹⁶⁵ Citing *Browning-Ferris*, the Court stated that the Excessive Fines Clause is a limitation on the government's power to extract payments, in whatever form, "as *punishment* for some offense."¹⁶⁶ However, quoting from *United States v. Halper*,¹⁶⁷ the Court stated that "[t]he notion of punishment, as we commonly understand it, cuts across the division between the civil and the criminal law."¹⁶⁸ In *Halper*, the Court held that a civil penalty whose imposition follows a previously imposed criminal sanction and that is "overwhelmingly disproportionate to the damages" caused by the offense may constitute double jeopardy under the Fifth Amendment.¹⁶⁹

¹⁶⁰ *Id.* at 605-06.

¹⁶¹ *Austin*, 509 U.S. at 622.

¹⁶² *Id.* at 606.

¹⁶³ *Id.* at 607.

¹⁶⁴ *Id.* at 607-08.

¹⁶⁵ *Id.* at 608-15. The Court took notice of three types of forfeiture actions that were established in England at the time of the Eighth Amendment's ratification. The first, deodand, was a common law action that sought the forfeiture of an inanimate object that caused the accidental death of a king's subject. *Id.* at 611 (citing *Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663, 680-81 (1974)). The second type of forfeiture, forfeiture of estates, escheated the lands and caused the forfeiture of chattels of a person convicted of treason or a felony to the Crown. *Id.* at 611-12 (citing *Calero-Toledo*, 416 U.S. at 682). The third type of forfeiture was imposed by statute and sought the forfeiture of objects used in the violation of customs and revenue laws. *Id.* at 612 (citing *Calero-Toledo*, 416 U.S. at 682). Only the third type of forfeiture was imported to the United States. *Id.* at 613 (citations omitted).

¹⁶⁶ *Id.* at 609-10 (quoting *Browning-Ferris Indus. of Vt., Inc. v. Kelco Disposal, Inc.*, 492 U.S. 257, 265 (1989)) (internal quotation marks omitted).

¹⁶⁷ 490 U.S. 435 (1989).

¹⁶⁸ *Austin*, 509 U.S. at 610 (quoting *United States v. Halper*, 490 U.S. 435, 447-48 (1989)) (internal quotation marks omitted).

¹⁶⁹ *Halper*, 490 U.S. at 435. In *Halper*, the Court confronted the issue of whether a \$2,000 civil penalty for each of sixty-five false claims violations amounted to a second punishment in violation of the Fifth Amendment. *Id.* at 438-40. The Court appeared to place a significantly less burden on an offender than a showing of gross disproportionality. According to the Court, whether such a penalty was

Sanctions serve remedial purposes, punitive purposes, or both. The stricture against excessive fines applies to sanctions that serve, whether in whole or in part, to punish.¹⁷⁰ The Court appeared to equate punishment with retribution and deterrence and examined the history of forfeitures in the United States.¹⁷¹ In the Court's view, *in rem* forfeitures are justified either by resort to the legal fiction that the property itself is guilty of an offense or by the notion that the property owner is held vicariously liable for the acts of others to whom he has entrusted his property.¹⁷² Both justifications are, according to Court, rooted in the notion that the property owner has been negligent when his property is misused.¹⁷³ Availing itself of tort law justifications for vicarious liability, the Court asserted that its rejection of an innocent-owner defense does not alter the fact that forfeitures are designed, at least in part, to punish the property owner.¹⁷⁴

The Court then proceeded to examine the particular forfeiture at issue in this case and held that the statutory forfeitures to which the petitioner was subjected were clearly punitive in nature.¹⁷⁵ Consequently, the Court reversed the decision of the Eighth Circuit and remanded the case for further proceedings.¹⁷⁶ The government's argument that narcotics forfeitures serve the remedial purposes of removing instruments of the drug trade from society and compensating the government for the law enforcement and social expenditures necessitated by the narcotics trade was curtly dismissed by the Court.¹⁷⁷ The forfeiture provisions at issue were clearly designed to

prohibited by the Double Jeopardy Clause is determined by a rule of reason: Where a defendant previously has sustained a criminal penalty and the civil penalty sought in the subsequent proceeding *bears no rational relation to the goal of compensating the Government for its loss*, but rather appears to qualify as "punishment" in the plain meaning of the word, then the defendant is entitled to an accounting of the Government's damages and costs to determine if the penalty sought in fact constitutes a second punishment.

Id. at 449-50 (emphasis added). Less than a decade later, the Court eviscerated the *Halper* standard in *Hudson v. United States*, 522 U.S. 93 (1997), and made it significantly more difficult for a civil monetary fine to serve as a predicate for a double jeopardy violation. For an analysis of *Halper* and *Hudson*, see generally Robin W. Sardegna, *No Longer in Jeopardy: The Impact of Hudson v. United States on the Constitutional Validity of Civil Monetary Penalties for Violations of the Securities Laws Under the Double Jeopardy Clause*, 33 VAL. U. L. REV. 115 (1998). An analysis of whether FBAR penalties may be challenged under the Double Jeopardy Clause is beyond the scope of this work.

¹⁷⁰ *Austin*, 509 U.S. at 610.

¹⁷¹ *Id.* at 610-18.

¹⁷² *Id.* at 614-15.

¹⁷³ *Id.* at 615. Justices Scalia and Kennedy distinguished between *in personam* forfeitures and *in rem* forfeitures. Although the former are based on the conduct of the person sanctioned, the latter are not necessarily predicated on the property owner's fault. In this case, both Justices believed that the petitioner was being punished for his actions. *Id.* at 623-28 (Scalia, J., concurring); *id.* at 628-29 (Kennedy, J., concurring).

¹⁷⁴ *Id.* at 618 (majority opinion).

¹⁷⁵ *Id.* at 619-622.

¹⁷⁶ *Austin*, 509 U.S. at 623.

¹⁷⁷ *Id.* at 620-21.

buttress criminal sanctions that are, in and of themselves, an inadequate deterrent to engage in an enormously profitable illegal trade.¹⁷⁸ Moreover, the existence of statutory innocent-owner exemptions merely served to more closely establish a nexus between the forfeiture and its punitive objective.¹⁷⁹

In *Alexander v. United States*,¹⁸⁰ a companion case to *Austin* that is perhaps more noteworthy for its First, rather than its Eighth, Amendment implications, the petitioner was convicted on multiple counts of transporting and selling obscene material and of three violations of the Racketeer Influenced and Corrupt Organization Act (“RICO”) that related to the petitioner’s adult entertainment business.¹⁸¹ As a result, the petitioner was sentenced to six years in prison, fined \$100,000, and ordered to pay costs.¹⁸² In addition, pursuant to the RICO statute, the petitioner was ordered to forfeit his wholesale and retail businesses and almost \$9 million.¹⁸³ The petitioner asserted that the RICO forfeiture amounted to a prior restraint on speech, a cruel and unusual punishment, and an excessive fine, and thus, violated both the First and Eighth Amendments.¹⁸⁴ The Court affirmed the Eighth Circuit’s holding that the forfeiture did no violence to the First Amendment and asserted that questions of proportionality are the purview of the Eighth Amendment and should not seep into First Amendment jurisprudence.¹⁸⁵

The Eighth Circuit rejected the petitioner’s Eighth Amendment argument on the ground that a proportionality review is not required in cases in which the punishment is less than life imprisonment without the possibility of parole.¹⁸⁶ The Court took exception with the Eighth Circuit’s reasoning and bifurcated the Cruel and Unusual Clause from the Excessive Fines Clause of the Eighth Amendment. The former clause concerns the terms of confinement while the latter clause “limits the government’s power to extract payments, whether in cash or in kind, as punishment for some offense.”¹⁸⁷ The fact that proportionality is maintained for purposes of the Cruel and Unusual Punishment Clause is not dispositive of the issue of whether a fine is constitutionally excessive. For Eighth Amendment purposes, the *in personam* criminal forfeiture under the RICO statute was a

¹⁷⁸ *Id.* at 620.

¹⁷⁹ *Id.* at 621-22.

¹⁸⁰ 509 U.S. 544 (1993)

¹⁸¹ *Id.* at 546-47.

¹⁸² *Id.* at 548.

¹⁸³ *Id.*

¹⁸⁴ *Id.* at 548-49.

¹⁸⁵ The Court rejected the argument that *ex-post* forfeitures or penalties, due to their chilling effect on speech, amount to prior restraints on speech. The potential size of such forfeitures or penalties was not a relevant factor in the Court’s holding. *See id.* at 549-50, 558 n.3.

¹⁸⁶ *Alexander*, 509 U.S. at 558.

¹⁸⁷ *Id.* (quoting *Austin v. United States*, 509 U.S. 602, 609-10 (1993)) (internal quotation marks omitted).

fine, defined by the Court as a payment to a sovereign as punishment for some offense.¹⁸⁸ Accordingly, the Court remanded the case to the Eighth Circuit Court for a determination of whether the forfeiture was excessive.

In its most recent decision concerning the Excessive Fines Clause, *United States v. Bajakajian*,¹⁸⁹ the Court held that the criminal forfeiture of the respondent's funds as a result of a currency reporting offense violated the Eighth Amendment.¹⁹⁰ In this case, the Court not only decided that the forfeiture was subject to Eighth Amendment scrutiny, but also determined the standard by which such punishments are tested for excessiveness. The Court also cast some doubt on whether *Austin* relegated the distinction between *in rem* and *in personam* forfeitures to history.

In *Bajakajian*, the respondent and his family were found with approximately \$357,000 in cash on their possession and in their baggage at Los Angeles International Airport prior to boarding a flight for Italy. The respondent pleaded guilty to one count of failing to report the transportation of more than \$10,000 outside the United States as required by 31 U.S.C. § 5316(a)(1)(A). Willful violations of the reporting requirement are subject to fines not exceeding \$250,000, imprisonment of not more than five years, or both.¹⁹¹ The government sought the forfeiture of the unreported cash pursuant to 18 U.S.C. § 982(a)(1) which provides, *inter alia*, for the forfeiture of any property involved in a violation of the currency reporting requirement.¹⁹² At trial, the district court found that the respondent's unreported funds, in their entirety, were subject to forfeiture.¹⁹³ The court further found that the funds were not connected to any other crime, were being transported to pay a lawful debt, and that the respondent's failure to report the funds was motivated by a fear and distrust of government that stemmed from the respondent's life experiences as an Armenian in Syria.¹⁹⁴ The court held that the total forfeiture of the funds would violate the Eighth Amendment because such a penalty would be "‘extraordinarily harsh’ and ‘grossly disproportionate to the offense in question.’"¹⁹⁵ Instead, the court sentenced the respondent to three years of probation, imposed the maximum fine under the Sentencing Guidelines, \$5,000, and ordered the forfeiture of \$15,000 of the unreported cash.¹⁹⁶

¹⁸⁸ *Id.*

¹⁸⁹ 524 U.S. 321 (1998).

¹⁹⁰ *Id.* at 324.

¹⁹¹ *Id.* at 325 n.2.

¹⁹² *Id.* at 325. The respondent was also charged with making a false material statement to the United States Customs Service but the government agreed to dismiss this charge. *Id.*

¹⁹³ *Id.* at 325-26.

¹⁹⁴ *Id.* at 326.

¹⁹⁵ *Bajakajian*, 524 U.S. at 326 (quoting from the trial transcript).

¹⁹⁶ *Id.*

The Ninth Circuit held that a forfeiture must satisfy two conditions in order to pass muster under the Excessive Fines Clause.¹⁹⁷ First, the property forfeited must be an instrumentality of the crime committed.¹⁹⁸ Second, the value of the property forfeited must be proportional to the culpability of the property's owner.¹⁹⁹ The court held that the currency in question was not an instrumentality of the crime because the crime in this case was the withholding of information and not the possession or transportation of the currency.²⁰⁰ Consequently, the Ninth Circuit had no need to proceed to the second prong of the test, proportionality, because the Eighth Amendment precludes the forfeiture of any property due to the failure to report currency.²⁰¹

The Court, citing *Browning-Ferris*, stated that the term "fine" is "a payment to a sovereign as punishment for some offense" and that the forfeiture provision at issue, imposed only after the conviction of an underlying felony, constituted punishment.²⁰² The Court rejected the government's contention that the forfeiture was outside the scope of the Eighth Amendment because it serves remedial purposes.²⁰³ The government asserted that the forfeiture deters illicit movements of cash and assists the government in investigating and detecting illegal activities associated with the cash.²⁰⁴ According to the Court, deterrence is a punitive function and the government's asserted loss of information is not remedied by the forfeiture.²⁰⁵ Moreover, the presence of a remedial purpose would not remove the forfeiture from the strictures of the Eighth Amendment if the forfeiture was punitive in part.²⁰⁶

The Court also rejected the government's contention that the forfeiture in this case bore the indicia of traditional civil *in rem* forfeitures that have not been deemed to be punitive in nature.²⁰⁷ In *Austin*, the Court placed little

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Bajakajian*, 524 U.S. at 327. The Ninth Circuit lacked the jurisdiction to set aside the \$15,000 fine imposed by the district court because the respondent did not raise this issue on appeal. *Id.*

²⁰² *Id.* at 327-28 (quoting *Browning-Ferris Indus. of Vt., Inc. v. Kelco Disposal, Inc.*, 492 U.S. 257, 265 (1989)) (internal quotation marks omitted). In *Austin*, the Court nodded approvingly to *Halper* and its holding that civil penalties could indeed trigger the application of the Double Jeopardy Clause of the Fifth Amendment. *See supra* note 164 and accompanying text. *Halper's* holding was effectively overturned in *Hudson v. United States*, 522 U.S. 93, 105 (1997). *Bajakajian* was decided one year after *Hudson* and the Court made no mention of *Hudson* in its opinion. Consequently, it would appear that nature of an exaction as punishment for Eighth Amendment purposes is not related to its nature for Fifth Amendment purposes.

²⁰³ *Bajakajian*, 524 U.S. at 329.

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ *Id.* at 329 n.4.

²⁰⁷ *Id.* at 330.

stock in the “guilty property” fiction that underpins civil *in rem* forfeitures.²⁰⁸ Curiously, the Court did not resort to the reasoning it employed in *Austin* and instead held that the forfeiture provision in this case bore the indicia of a criminal *in personam* forfeiture, which have historically been deemed punitive in nature.²⁰⁹ The fact that the government did not proceed against the property *in rem*, but rather proceeded against the respondent, criminally belied the government’s contention that the forfeiture was a typical instrumentality forfeiture.²¹⁰ The Court also noted its agreement with the Ninth Circuit that the currency in this case was not an instrumentality of the offense.²¹¹ The Court’s decision in this case appears to contradict its holding in *Austin* because it seemingly leaves instrumentality forfeitures immune from Eighth Amendment limitations. In its footnote eight, the Court stated that “[i]nstrumentality” forfeitures have historically been limited to the property actually used to commit an offense and no more. . . . A forfeiture that reaches beyond this strict historical limitation is *ipso facto* punitive and therefore subject to review under the Excessive Fines Clause.”²¹²

Having determined that the forfeiture of the respondent’s funds was punitive the Court then turned to the issue of whether such forfeiture was excessive. “The touchstone of the constitutional inquiry under the Excessive Fines Clause is the principle of proportionality: The amount of the forfeiture must bear some relationship to the gravity of the offense that it is designed to punish.”²¹³ The Court found no support in the text of the Constitution and little guidance in the historical record for the application of the proportionality standard.²¹⁴ Given the dearth of precedents applicable to the Excessive Fines Clause, the Court resorted to its decisions concerning the Cruel and Unusual Punishment Clause and held that “judgments about the appropriate punishment for an offense belong in the first instance to the legislature.”²¹⁵ Moreover, judicial determinations concerning the gravity of an offense are inherently imprecise.²¹⁶ Accordingly, deference to the legislature and the recognition of the inherent limitations of judicial expertise caused the Court to adopt a standard of gross, as opposed to strict, proportionality that it has adopted in the application of the Cruel and Unusual Punishment Clause.²¹⁷ As a result, a fine is excessive only if it is grossly disproportionate to the gravity of the offense for which it is imposed.²¹⁸

²⁰⁸ See *supra* notes 164-66 and accompanying text.

²⁰⁹ *Bajakajian*, 524 U.S. at 331-33.

²¹⁰ *Id.* at 333.

²¹¹ *Id.* at 334 n.9.

²¹² *Id.* at 333 n.8.

²¹³ *Id.* at 334.

²¹⁴ *Id.* at 335-36.

²¹⁵ *Bajakajian*, 524 U.S. at 336 (citing *Solem v. Helm*, 463 U.S. 277, 290 (1983)).

²¹⁶ *Id.*

²¹⁷ *Id.*

²¹⁸ *Id.* at 337.

The Court held, for several reasons, that the forfeiture of approximately \$357,000 in this case would violate the Excessive Fines Clause.²¹⁹ First, the crime for which the forfeiture was sought was solely a reporting violation.²²⁰ The possession and transport of currency were permissible activities. Second, the reporting violation in this case was unrelated to any other illegal activities.²²¹ The respondent did not fall within the class of persons—money launderers, drug traffickers, and tax evaders—for whom the reporting obligation was designed.²²² Third, the maximum penalties provided under the Sentencing Guidelines confirmed the respondent's minimal level of culpability.²²³ Fourth, the harm caused by the respondent's offense was minimal.²²⁴ The failure to report the currency in this case resulted in no loss to the public fisc and the harm to the government was limited to its deprivation of information.²²⁵ Moreover, the Court found that there is no correlation between the amount forfeited and the harm that the government would have suffered had the offense gone undetected.²²⁶

Finally, the Court dismissed the notion that the proportionality of full forfeiture is evidenced by statutes enacted by the First Congress that required full forfeiture of goods, or the equivalent in monetary fines, involved in customs offenses. According to the Court, the penalties imposed by such statutes were remedial, not punitive, in nature and were designed to protect the government's interest in customs revenue.²²⁷ The fact that the amount of such penalties could be a multiple of the value of the goods reflected Congress's judgment as to the losses that the government could incur and did not alter their remedial nature.²²⁸ The Court again appeared to place emphasis on the fact that such penalties were enforced in civil *in rem* procedures.²²⁹

²¹⁹ *Id.* at 337 n.11. The Court did not have before it the questions of whether the \$15,000 fine imposed by the district court was grossly disproportional or whether a court may disregard the statute and order a forfeiture of an amount less than the amount mandated by the statute. *Id.*

²²⁰ *Id.* at 337.

²²¹ *Bajakajian*, 524 U.S. at 337-38.

²²² *Id.* at 338.

²²³ *Id.* at 338-39.

²²⁴ *Id.* at 339.

²²⁵ *Id.*

²²⁶ *Id.*

²²⁷ *Bajakajian*, 524 U.S. at 340-43.

²²⁸ *Id.* at 342. The First Circuit also examines whether the penalty at issue deprives the defendant of the ability to earn a livelihood. However, this factor, by itself, if not outcome determinative. *See United States v. Fogg*, 666 F.3d 13, 19-20 (1st Cir. 2011).

²²⁹ *Bajakajian*, 524 U.S. at 342-43 & n.18.

III. FBAR PENALTIES AND THE EXCESSIVE FINES CLAUSE

A. *Application of the Eighth Amendment*

The FBAR regime subjects taxpayers to both civil and criminal penalties. Criminal fines of up to \$500,000 and imprisonment for no longer than ten years, or both, are the maximum criminal sanctions for reporting violations when such violations occur in the course of violations of certain other laws.²³⁰ Otherwise, the maximum criminal sanctions are halved.²³¹ Civil penalties vary widely based on whether the violation was willful, whether mitigation provisions are applicable, whether the taxpayer has entered the OVDP, and the balance of the unreported account.²³² Consequently, it is difficult to generalize as to whether the imposition of a particular civil penalty violates the Excessive Fines Clause. Analysis of this issue is akin to the analysis of an “as applied” challenge to the constitutionality of a statute rather than the analysis of a facial challenge to its constitutionality. Therefore, in order to assess whether the Excessive Fines Clause provides an inherent limitation to the imposition of civil penalties under the FBAR rules, I assume that the maximum permissible civil penalty for willful violation of the reporting requirements is imposed. This maximum penalty is 50 percent of the account balance for each reporting violation.²³³ In the example previously set forth, the taxpayer failed to report an account whose balance began at \$10,000,000 and reached its apex of \$13,382,256 five years hence.²³⁴ The maximum FBAR penalties, in addition to other penalties, amounted to \$29,876,593.²³⁵

The threshold issue is whether the FBAR civil penalty is amenable to Eighth Amendment scrutiny. As the Court made clear in *Austin*, the classification of an exaction as civil or criminal is not determinative.²³⁶ Instead, the Excessive Fines Clause is a limitation on any exaction imposed by the sovereign that is punitive in nature.²³⁷ Moreover, because the FBAR penalty is not an *in rem* forfeiture, the Court’s apparent resuscitation of the *in rem/in personam* distinction in *Bajakajian* is not relevant.²³⁸ The statute does not impose a forfeiture of the funds contained in undisclosed accounts but rather a monetary fine based on the balances of such accounts.²³⁹ More-

²³⁰ See *supra* note 41.

²³¹ See *supra* note 41.

²³² See *supra* notes 37-94 and accompanying text.

²³³ See *supra* note 39 and accompanying text.

²³⁴ See *supra* notes 127-29 and accompanying text.

²³⁵ See *supra* note 134 and accompanying text.

²³⁶ See *supra* notes 163-68 and accompanying text.

²³⁷ See *supra* note 166 and accompanying text.

²³⁸ See *supra* notes 207-10 and accompanying text.

²³⁹ See *supra* note 38 and accompanying text.

over, in light of the Court's holding in *Bajakajian*, it is unlikely that the direct forfeiture of the undisclosed accounts would obtain immunity as an "instrumentality" forfeiture. Similar to the undeclared currency in that case, the funds in an undisclosed foreign financial account are not the instrumentality of an offense.²⁴⁰ The offense is not the presence of a foreign financial account but the failure to disclose such account.

There is little doubt that the FBAR regime is punitive in nature. The purpose of the statutory and regulatory edifice is to deter taxpayers from secreting funds in foreign financial accounts in order to evade U.S. tax obligations and from hindering government efforts to ascertain the existence of illicit activities such as money laundering and terror financing. As the Court noted in both *Austin* and *Bajakajian*, deterrence is punitive in nature.²⁴¹ Any remedial purpose served by the penalty regime does not vitiate its deterrent aspect as a trigger for Eighth Amendment scrutiny.²⁴²

The heightened penalties for willful violations of the reporting requirements, the existence of a reasonable cause exception to the imposition of the penalty, and the fact that no penalty is imposed if no taxes are due evidence the punitive nature of the FBAR penalty.²⁴³ Moreover, the fact that participation in the OVDP, a program that offers taxpayers significantly reduced sanctions in exchange for their voluntary cooperation, is not available to taxpayers under examination or criminal investigation further evidences the deterrent aspect of the statutory penalties.²⁴⁴

B. *Gross Disproportionality Test*

Despite the relatively pedestrian determination that the FBAR penalties are subject to Eighth Amendment scrutiny, whether such penalties are, in fact, grossly disproportionate to the offense is a much more difficult question to answer. The factors that the Court applied in *Bajakajian* to determine whether a sanction is grossly disproportionate do not point in one direction with respect to FBAR sanctions.

Similar to the respondent's transgression in *Bajakajian*, an FBAR violation is a reporting violation. It is not illegal to establish and maintain a foreign financial account, but it is illegal to fail to report such account. However, unlike the forfeiture sought against the respondent in *Bajakajian*, maximum FBAR penalties are imposed when the taxpayer's failure to re-

²⁴⁰ See *supra* notes 198-200 and accompanying text.

²⁴¹ See *supra* notes 171, 205 and accompanying text.

²⁴² See *supra* notes 177, 206 and accompanying text.

²⁴³ See *supra* note 85 and accompanying text. The Court in *Austin* stated that the existence of exceptions to sanctions based on behavior evidences the punitive nature of such sanctions. See *supra* note 179 and accompanying text.

²⁴⁴ See *supra* notes 70-97 and accompanying text.

port is coupled with another offense committed by the taxpayer: tax evasion. In *Bajakajian*, the Court also compared the sought after sanction to the maximum criminal penalty imposed by the statute and the Sentencing Guidelines in order to assess the offender's culpability.²⁴⁵ The maximum criminal fine for failure to report foreign financial accounts is \$500,000, ten years imprisonment, or both.²⁴⁶ Obviously, Congress has judged persons that fail to report foreign financial accounts to be culpable to a great degree.

It is not clear whether this sort of comparison is as informative for nonforfeiture penalties such as FBAR penalties. In certain forfeiture cases, the amount subject to forfeiture may have little relation to the harm caused and could result in significant variations in the level of punishment meted out to defendants who have committed similar offenses. For example, in *Bajakajian*, the respondent could have possessed \$10,001 or \$10,000,000, but the harm caused by his offense would have been unchanged. Maximum FBAR penalties are based on the value of the unreported accounts and, in theory, the greater the balance that exists in the account, the greater the potential for tax evasion becomes. However, despite the fact that the extent of tax evasion is correlated with the extent of the assets that generate unreported income, in particular cases the extent of such tax evasion may vary widely among taxpayers with equivalent unreported account balances.²⁴⁷ As a method to deter tax evasion penalties based on asset values bear a theoretical proportionality to the offense but in practice they may not operate differently than forfeitures in this respect.

Finally, the harm caused by the offense must be examined. The FBAR rules are banking rules and not tax rules. They have broad law enforcement purposes, including the provision of assistance in the enforcement of various non-tax laws such as the narcotics laws.²⁴⁸ Foreign financial accounts may have been funded with the proceeds of illegal activities, and information as to the existence of such accounts may provide law enforcement authorities with valuable information with respect to the illegal activities that were the source of the funds. The fact that multiple parties, including persons with no beneficial interest in an account, may have reporting obligations over the same account evidences a law enforcement purpose beyond the policing of tax evasion.²⁴⁹ Moreover, the fact that so-called "quiet disclosures," the filing of amended returns with all income reported, will not assure immunity from criminal prosecution also appears to support a pur-

²⁴⁵ See *supra* notes 219-26 and accompanying text.

²⁴⁶ *Professional Responsibility and the Report of Foreign Bank and Financial Accounts*, INTERNAL REVENUE SERV., <http://www.irs.gov/pub/irs-utl/Professional%20Responsibility%20and%20the%20Report%20of%20Foreign%20Bank%20and%20Financial%20Accounts%20web%20write-up%206-7-2013.pdf> (last visited Oct. 20, 2014).

²⁴⁷ See *infra* notes 282-83 and accompanying text.

²⁴⁸ See *supra* note 7 and accompanying text.

²⁴⁹ See *supra* notes 26-35 and accompanying text.

pose broader than tax collection.²⁵⁰ Although third-party reporting may shine some light on the fruits of illicit activities, it is unlikely that penalties for the failure to self-report foreign accounts are an effective deterrent to non-reporting by narco-traffickers, gun-runners, and their ilk.

Without question, however, the deterrence of tax evasion is a purpose of the reporting requirements and a tax evader is certainly the target of the statute. The enforcement of the FBAR rules appear targeted at tax evasion, perhaps exclusively so. The fact that the IRS will not impose penalties on persons who have fully and timely reported their income belies the significance of any objective beyond the prevention of tax evasion. Moreover, the FBAR penalties are not dependent on whether the tax evasion resulted from unreported illicit income or legitimate income. Tax evasion, however, is subject to a separate and rather harsh regime of civil and criminal sanctions. Perhaps the outcome of a gross disproportionality inquiry should be informed by the nature of the income in question and greater deference shown to penalties applicable to unreported assets that are sourced to illicit pursuits such as narcotics or gun trafficking operations. If, however, the reporting violation serves as cover for tax evasion and nothing more, then the draconian penalties that are possible under the FBAR rules may very well be excessive.

It is unclear whether and to what extent separate and distinct civil sanctions for tax evasion should inform the inquiry into the gross disproportionality of the FBAR sanctions. The Court deferred to Congress as the best judge of the societal harm caused by a particular offense. Although the Court in *Bajakajian* placed importance on whether the violation at issue was coupled with another crime, it did not indicate, either explicitly or implicitly, whether and to what extent the punishments for such other offense should factor into the determination of gross disproportionality. Other courts similarly have failed to indicate whether the existence of civil penalties for such other offenses is relevant to the determination of gross disproportionality.²⁵¹ Congress has spoken directly to the seriousness of tax eva-

²⁵⁰ See *supra* note 84 and accompanying text.

²⁵¹ See, e.g., *United States v. \$134,750 U.S. Currency*, 535 Fed. Appx. 232 (4th Cir. 2013). The Fourth Circuit held that the forfeiture of \$134,750 in currency was constitutional. In this case, the owner of currency deliberately structured cash deposits in amounts designed to avoid triggering the imposition of reporting obligations on the depository financial institutions. The currency owner was not charged with money laundering or tax evasion but the court noted that “his structuring violations ‘could have facilitated such conduct in just the way the statute was designed to frustrate.’” *Id.* at 241 (quoting *United States v. Malewicka*, 664 F.3d 1099, 1105-6 (7th Cir. 2011)). The court proceeded to compare the forfeited amount to the \$500,000 maximum criminal penalty for the violation at issue. *Id.* No discussion was made with respect to the existence of civil penalties for tax evasion. Unlike financial reporting violations designed to ferret out other offenses, forfeiture cases generally implicate offenses for which there exists no separate civil sanctions and, therefore, the courts have a clear basis for comparison. For example, in *United States v. Cheeseman*, the court held that the forfeiture of approximately \$500,000 of firearms and ammunition was constitutional. 600 F.3d 270, 284-85 (3d Cir. 2010). The respondent pled

sion and has provided specific and harsh criminal and civil penalties. As noted in the example above, a taxpayer that willfully failed to report income from foreign financial accounts faces several penalties, including the 40 percent understatement penalty, the 75 percent fraud penalty, and criminal sanctions.²⁵² The specificity with which Congress has spoken with respect to tax evasion arguably supports the notion that the FBAR regime should be limited to the punishment of the reporting offense and not to the tax evasion. Moreover, the FATCA rules, which have similar, though not identical, reporting requirements and objectives, are significantly less punitive.²⁵³

The existence of the OVDP adds little clarity to whether the FBAR penalties are grossly disproportionate. On the one hand, the opportunity for a taxpayer to come clean justifies harsh treatment in cases in which the taxpayer snubbed her nose at such an opportunity.²⁵⁴ On the other hand, the fact that the penalties imposed under the OVDP are significantly less than the statutory penalties supports the notion that the harm caused by the tax evasion is dramatically overstated by such statutory penalties.²⁵⁵

Support for harsh reporting penalties is derived both from the importance of the tax collection function to the operation of the government and from the fact that the efficacy of such function is highly dependent upon voluntary taxpayer compliance. The importance of the tax collection function is evidenced by both the administrative discretion enjoyed by the IRS and the statutory barriers to pre-enforcement judicial challenges of tax matters.²⁵⁶ The IRS's laxity in complying with the Administrative Procedure Act ("APA") is well known.²⁵⁷ Except for military, foreign affairs, and certain managerial, personnel, and other matters not relevant here, the APA requires that notice and comment procedures be adhered to in the promul-

guilty to violating a federal statute that prohibited the possession of firearms and ammunition by an unlawful drug user. The court examined the forfeiture in light of the Sentencing Guidelines' upper limit, \$75,000, and the maximum statutory penalty of \$250,000. *See id.* *See also* United States v. Blackman, 746 F.3d 137, 145 (4th Cir. 2014) (ordering the forfeiture of the value of stolen goods, \$136,601.03, which was below the maximum statutory fine of \$250,000).

²⁵² *See supra* notes 130-36 and accompanying text.

²⁵³ *See supra* notes 109-17 and accompanying text.

²⁵⁴ The Court in *Bajakajian* rejected the notion that repeated falsehoods increase culpability. United States v. Bajakajian, 524 U.S. 321, 337 n.12 (1998).

²⁵⁵ *See supra* note 136 and accompanying text.

²⁵⁶ These are by no means the only evidence of the importance of the tax collection function. For example, the government is a priority creditor in bankruptcy with respect to certain tax obligation due to it and many tax obligations are not dischargeable in bankruptcy. *See* 11 U.S.C. §§ 507(a)(8), 523(a)(1) (2012). In addition, the statutory lien provisions for unpaid taxes are very broad and bypass state secured lending and real property law. *See generally* I.R.C. §§ 6321-6327 (2012). The IRS is also granted broad levy powers. *See generally id.* §§ 6331-6334.

²⁵⁷ *See generally* Kristin E. Hickman, *A Problem of Remedy: Responding to Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 76 GEO. WASH. L. REV. 1153, 1155 (2008).

gation of proposed regulations.²⁵⁸ The notice and comments requirements do not apply to interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice.²⁵⁹ The Treasury derives its regulatory authority from two sources: a delegation of authority to issue rules and regulations pursuant to a specific statutory provision and I.R.C. § 7805(a) (2012) which delegates general regulatory authority to the Treasury for the enforcement of the I.R.C.²⁶⁰ The Treasury has long taken the position that regulations issued under the latter delegation of authority are interpretative and, therefore, not subject to the notice and comment provisions of the APA.²⁶¹ Moreover, it has become a common practice of the Treasury to issue binding temporary regulations contemporaneously with a Notice of Proposed Rulemaking.²⁶² Thus, the temporary regulations are binding upon taxpayers without any opportunity for pre-promulgation comment.²⁶³

²⁵⁸ 5 U.S.C. §§ 553(a)-(b) (2012).

²⁵⁹ *Id.* § 553(b). An agency may dispense with notice and comment if it, with good cause, finds that such notice and comment procedures are impractical, unnecessary, or contrary to the public interest. *Id.*

²⁶⁰ I.R.C. § 7805(a). Under the Internal Revenue Code, regulatory authority is delegated to secretary of the treasury. The IRS, however, has a significant role in the drafting of regulations. *See Hickman, supra* note 257, at 1154 n.3. Specific grants of regulatory authority often vary among particular statutory provisions. At one extreme are statutes that limit the grant of authority to designated issues. At the other extreme are statutes that grant broad authority to carry out the provisions of the statute. Other statutes grant authority the scope of which lies somewhere in between these extremes. *See, e.g.,* I.R.C. §§ 263A(i), 409A(e), 469(l).

²⁶¹ *See Hickman, supra* note 257, at 1158. The author cites a study of 232 regulatory projects for which the notice and comment requirement was explicitly disclaimed in almost 92 percent of such projects. *Id.* at 1158 n.16. This distinction has been criticized by several commentators and discounted by the courts. *See, e.g.,* Mayo Found. for Med. Educ. & Research v. United States, 131 S. Ct. 704, 713-15 (2011) (applying the same standard of deference to regulations issued under a general grant of authority that is applied to other regulations); Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 844 (1984) (stating that oftentimes legislative delegations are implicit); Swallows Holding, Ltd. v. Comm’r, 515 F.3d 162, 168-69 (3d Cir. 2008) (holding that regulations promulgated pursuant to I.R.C. § 7805 have the force of law); Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury’s (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 NOTRE DAME L. REV. 1727, 1760-73 (2007). *See also* Irving Salem et al., *ABA Section of Taxation Report of the Task Force on Judicial Deference*, 57 TAX LAW. 717, 718 (2004). Congress has expressed a small modicum of concern with this practice. For example, it expressly requires Treasury’s compliance with the provisions of the Regulatory Flexibility Act regardless of whether the regulations are deemed legislative or interpretative. *See* 5 U.S.C. § 603(a) (2012).

²⁶² *See Hickman, supra* note 257, at 1160. Temporary regulations must also be issued as proposed regulations and expire within three years of issuance. I.R.C. § 7805(e).

²⁶³ More problematic is the IRS’s use of informal rulemaking in the form of revenue rulings and notices. Revenue rulings are official, published interpretations of the tax law applicable to a particular set of facts and are designed to promote the uniform application of the tax laws and assist taxpayers in voluntarily complying with such laws. *See* Rev. Proc. 2003-1, 2003-1 C.B. 1; Rev. Proc. 89-14, 1989-1 C.B. 814. *See also Understanding IRS Guidance—A Brief Primer*, INTERNAL REVENUE SERV., <http://www.irs.gov/irs/article/0,,id=101102,00.html> (last updated Feb. 12, 2014). Each weekly Internal Revenue Bulletin, in which the rulings are published, explicitly states that these rulings do not have the

In addition, the deferential judicial standard of review of agency actions set forth by the Supreme Court in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*²⁶⁴ has been expanded with respect to review of actions taken by the IRS.²⁶⁵ Under *Chevron*, if the statute that is the subject of the agency action does not directly address the precise question at issue then an agency action that had been subject to notice and comment will not be disturbed unless it is found to be arbitrary, capricious in substance, or manifestly contrary to the statute.²⁶⁶ Prior to *Chevron*, the Court applied a less deferential, multi-factor test to determine whether agency regulations were a permissible interpretation of a statute—the so-called *National Muffler* test.²⁶⁷ The Court limited *Chevron* deference to Treasury regulations issued under a specific statutory grant of authority and continued to apply the *National Muffler* test to Treasury regulations issued under the general statutory grant of authority under I.R.C. § 7805 (2012).²⁶⁸ However, in 2011, the Court in *Mayo Foundation for Medical Education and Research v. United States*²⁶⁹ held that the *Chevron* standard applied to all Treasury regulations issued after notice and comment.²⁷⁰ Accordingly, like any other agency regulations, tax regulations, regardless of their source of authority, are entitled to *Chevron* deference.²⁷¹

Judicial review of final agency actions is presumed under the APA.²⁷² However, judicial review of tax actions is circumscribed by I.R.C. § 7421

force and effect of regulations but that they may be used as precedent by taxpayers. IRS notices are often used to provide guidance pending the issuance of a ruling or proposed regulations and they may contain substantive interpretations of the tax law. *See id.*

²⁶⁴ 467 U.S. 837 (1984).

²⁶⁵ *Id.* at 865.

²⁶⁶ *See* United States v. Mead Corp., 533 U.S. 218, 219 (2001).

²⁶⁷ The courts examined whether the regulations in question were a contemporaneous construction of the statute promulgated with the awareness of congressional intent; the length of time that the regulations were in effect; the degree of reliance placed on the regulations by affected parties; the consistency of the agency's position; and the degree of scrutiny given the regulations by Congress during subsequent re-enactments of the statute. *Nat'l Muffler Dealers Ass'n, Inc. v. United States*, 440 U.S. 472, 477 (1979).

²⁶⁸ *See, e.g.,* United States v. Vogel Fertilizer Co., 455 U.S. 16, 24 (1982); *Rowan Cos. v. United States*, 452 U.S. 247, 253 (1981).

²⁶⁹ 131 S. Ct. 704 (2011).

²⁷⁰ *Id.* at 713-15. It has been argued that a lesser standard of deference could be justified for tax regulations due to the inherent advantages enjoyed by the IRS over taxpayers. *See Salem et al., supra* note 261, at 723-24.

²⁷¹ *Mayo*, 131 S. Ct. at 713. Informal agency guidance, however, is not entitled to *Chevron* deference. In *United States v. Mead*, the Court applied a much less deferential standard of review to a customs service ruling and stated explicitly that this standard of review—the *Skidmore* standard—survived *Chevron*. *Mead*, 533 U.S. at 226-27. Under *Skidmore*, the weight that a court will give an agency action depends upon the thoroughness of the agency's deliberations, the validity of its reasoning, its consistency with earlier and later pronouncements, and other factors which provide the agency with the power to persuade. *See Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944).

²⁷² *See Abbott Labs. v. Gardner*, 387 U.S. 136, 140 (1967).

(2012), the Anti-Injunction Act.²⁷³ This statute prohibits, subject to a few exceptions, any “suit for the purpose of restraining the assessment or collection of any tax . . . in any court by any person, whether or not such person is the person against whom such tax was assessed.”²⁷⁴ In effect, section 7421 requires that taxpayers resolve their tax disputes in a suit for refund and provides legislative notice of the “[g]overnment’s need to assess and collect taxes as expeditiously as possible with a minimum of preenforcement judicial interference.”²⁷⁵ The Tax Injunction Act also precludes lower federal court interference with the assessment, levy, or collection of any tax under state law.²⁷⁶ In addition, the Declaratory Judgment Act precludes any declaratory judgments “with respect to Federal taxes.”²⁷⁷

The U.S. tax system depends, to an extraordinary extent, on voluntary compliance by taxpayers. In general, voluntary subjugation to any regulatory scheme is a function of the existence of effective deterrents to noncompliance and the reputational harm attendant to noncompliance.²⁷⁸ Reputational harm is, in turn, dependent upon cultural norms and transparency.²⁷⁹

²⁷³ I.R.C. § 7421 (2012).

²⁷⁴ *Id.* § 7421(a). The federal district court may, among other exceptions, issue an injunction to prevent irreparable harm to the property rights of others in the context of a levy or sale of property by the IRS. *See id.* § 7426(b). Moreover, third parties are expressly provided standing to vindicate an interest in property that has been wrongfully levied. *Id.* § 7426(a). Exceptions to the statute are also provided for collection activities undertaken in certain cases involving innocent-spouse relief and during the pendency of a Tax Court proceeding challenging federal liens and levies. *See id.* §§ 6015(e)(1)(B)(2), 6330(e).

²⁷⁵ *Hibbs v. Winn*, 542 U.S. 88, 103 (2004) (citing *Enochs v. Williams Packing & Navigation Co.*, 370 U.S. 1, 7 (1962)) (internal quotation marks omitted). The Court has held, however, that neither the Anti-Injunction Act nor the Tax Injunction Act operates to bar proceedings that, if successful, have the effect of increasing tax revenue. *Id.* at 102-12. *See also* *E. Ky. Welfare Rights Org. v. Simon*, 506 F.2d 1278, 1283-85 (D.C. Cir. 1974). Despite its broader language, the Declaratory Judgment Act has been held to be coterminous with the anti-injunction statutes and, therefore, is similarly no bar to such actions. *See id.* at 1284-86. The Court has also acknowledged two, albeit narrow, common law exceptions to the Anti-Injunction Act. First, a pre-enforcement challenge may be allowed if the government could not prevail under any circumstances and the taxpayer would suffer irreparable harm from enforcement action. *See Enochs*, 370 U.S. at 6-7. Second, a pre-enforcement action is permitted if, under the circumstances, no other legal remedy is available. *See South Carolina v. Regan*, 465 U.S. 367, 378, 380-81 (1984).

²⁷⁶ 28 U.S.C. § 1341 (2012).

²⁷⁷ *Id.* § 2201(a). An exception is provided in the statute for declaratory judgments relating to the determinations of the tax exempt status of certain organizations. *Id.*; I.R.C. § 7428.

²⁷⁸ One scholar believes that high tax penalties increase compliance through deterrence, separation, and signaling. Separation refers to the propensity for high penalties to prompt taxpayers to self-identify as compliant thereby permitting the government the ability to observe non-compliant groups. Signaling refers to the reputational enhancing benefits to taxpayers in signaling their compliance. Reputational benefits are distinct from what the author terms “warm glow” effects such as self-satisfaction or a sense of patriotism. *See* Susan C. Morse, *Tax Compliance and Norm Formation Under High-Penalty Regimes*, 44 CONN. L. REV. 675, 681-83 (2012).

²⁷⁹ *See id.* at 685-86, 692.

Deterrence can, over time, heighten the reputational harm incident to non-compliance by nudging cultural norms toward compliance.²⁸⁰ Conversely, the potential for significant reputational damage is a further deterrent to noncompliance because it increases the cost of such noncompliance if it is discovered.²⁸¹

The size of the sanctions for noncompliance and the probability of detection are key variables with respect to the efficacy of the deterrents. These two variables have mutually dependent properties because the probability of detection should influence the size of the sanctions.²⁸² For example, if there is 100 percent certainty of detection, then a penalty that slightly exceeds the benefits gained from noncompliance should be sufficient to deter noncompliance.²⁸³ Alternatively, if the detection rate is 5 percent then the sanction must be set sufficiently high so as to overcome the low probability of detection. Criminal sanctions, particularly the possibility of imprisonment, serve this function.²⁸⁴

Levels of voluntary compliance are high in the United States.²⁸⁵ For the most part, the third-party reporting requirements with respect to wages, interest, dividends, and many other forms of income ensure an extremely

²⁸⁰ *Id.* at 685-86.

²⁸¹ *Id.*

²⁸² See generally Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 193 (1968). In the tort realm, support for punitive damages is based, in part, on analogous reasoning. See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 194, 203 (3d ed. 1986); W. Kip Viscusi, *The Challenge of Punitive Damages Mathematics*, 30 J. LEGAL STUD. 313, 315 (2001) (noting that this rationale can be traced to the writings of Jeremy Bentham).

²⁸³ The amount of the penalty must consider the time value of money and the possibility that taxpayer's arbitrage the statutory interest charge that is imposed. For example, a taxpayer who underpays tax and is forced to repay such tax plus interest at 3 percent is unlikely to be deterred from non-compliance if she earns 15 percent on the funds that should have been paid to the government.

²⁸⁴ Of course, most, if not all, taxpayers are aware of the *mens rea* requirement and the steep burden of proof imposed on the government in proving criminal charges. The dearth of criminal prosecutions related to the meltdown of the mortgage market is testament to the hurdles faced by the government in bringing and winning criminal charges. Other, more cynical explanations also have been put forth for the meager number of criminal prosecutions related to the mortgage crisis. See, e.g., Jesse Eisinger, *Seeking Tough Justice, but Settling for Empty Promises*, N.Y. TIMES, May 8, 2014, at B5 (late ed.) (criticizing the Justice Department's efforts in prosecuting executives); Ben Protess, *Key U.S. Prosecutor Is Latest to Join Law Firm*, N.Y. TIMES, April 29, 2014, at B9 (late ed.) (reporting that another senior Justice Department official announced her departure to join a prominent white collar defense law firm and that perhaps the "revolving door" has blurred the lines between prosecutors and defense attorneys).

²⁸⁵ See Morse, *supra* note 278, at 679 (citing a 2006 Dep't of the Treasury report). See also *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study*, INTERNAL REVENUE SERV. (Jan. 6, 2012), <http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates;-Compliance-Rates-Remain-Statistically-Unchanged-From-Previous-Study> [hereinafter *IRS Releases New Tax Gap Estimates*] (estimating a compliance rate in 2006 of approximately 83 percent, a rate that was virtually unchanged from the compliance rate estimated in 2001).

high detection rate for noncompliance.²⁸⁶ Historically, income generated from foreign financial accounts has not been subject to third-party reporting and its non-reporting by taxpayers has not shared the high detection rate attendant to the non-reporting by taxpayers of most domestic source income. Moreover, the extremely low audit rates for individual taxpayers hardly adjust the detection rate upward to any meaningful degree.²⁸⁷ Consequently, significant sanctions appear warranted to deter noncompliance.

One would expect that the high level of voluntary tax compliance in the United States has created a strong cultural norm of compliance thereby heightening the reputational harm of non-compliance. Whether or not the United States enjoys the benefits of such a norm is beyond the scope of this work.²⁸⁸ Anecdotally, however, it is arguable that the high levels of voluntary compliance are attributable to deterrence and not to the behavioral effects of a cultural norm. Certain segments of the taxpayer population whose noncompliance is not easily detected are notorious for noncompliance—small businesses, for example.²⁸⁹ Moreover, dissatisfaction with the tax system at both ends of the political spectrum is widespread as evidenced by the emergence of the Tea Party movement on the right and the incessant calls by the left for the rich to pay their fair share.²⁹⁰ Moreover, the existence of a

²⁸⁶ See, e.g., I.R.C. § 6041 (2012) (requiring persons engaged in a trade or business to report payments of wages, salaries, rents, and certain other items); *id.* § 6042 (requiring the reporting of dividend payments); *id.* § 6045 (requiring brokers to report gross proceeds derived by customers); *id.* § 6049 (requiring the reporting of interest payments). The IRS estimated that the rate of underreporting of wage and salary income in 2006 was one percent. See *IRS Releases New Tax Gap Estimates*, *supra* note 285.

²⁸⁷ The audit rate for the fiscal year ended September 30, 2013 was approximately 1 percent. See INTERNAL REVENUE SERV., PUB. NO. 55B, INTERNAL REVENUE SERVICE DATA BOOK, 2013, at 22 tbl.9a (2014), available at <http://www.irs.gov/pub/irs-soi/13databk.pdf>. The IRS does seek to identify higher risk taxpayers for audits through the use of statistical methods. See generally William Hoffman, *IRS Doesn't Target Small Businesses for Audits, Werfel Says*, 140 TAX NOTES 304 (2013).

²⁸⁸ A recent cross-country study found that attitudes toward tax compliance in the United States are influenced by taxpayers' education levels, gender, and age. See Robert W. McGee & Adriana M. Ross, Education Level and Ethical Attitude Toward Tax Evasion: A Six-Country Study 31-35 (Mar. 17, 2014) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2410582.

²⁸⁹ Such taxpayers have non-compliance rates of approximately 50 percent. See Susan Cleary Morse et al., *Cash Businesses and Tax Evasion*, 20 STAN. L. & POL'Y REV. 37, 39 (2009). The IRS estimated that the gross tax gap in 2006 was approximately \$450 billion. The vast majority of the tax gap is attributable to underreported income and, in contrast to income subject to third party reporting, income not such subject to such reporting was misreported at a 56 percent rate in 2006. See *IRS Releases New Tax Gap Estimates*, *supra* note 285.

²⁹⁰ For a detailed discussion of norm building in the tax context, see Richard Lavoie, *Vox Clamantis in Deserto: The Role of the Individual in Forging a Strong Duty to the Tax System* (Univ. of Akron Sch. of Law Legal Studies Research Paper Series, Paper No. 14-02, 2014), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2404052##. Behavioral economists recently conducted field experiments in the United Kingdom on the efficacy of simple techniques, such as adding language to requests for payments indicating compliance rates and the need of funds to support vital services, in nudging taxpayer behavior toward compliance. See generally Michael Hallsworth et al., *The*

strong cultural norm of compliance may do little to heighten reputational harm for most would-be tax evaders. Many such tax evaders are not motivated by the potential effects of reputational damage and those that are so motivated may take comfort in the fact that tax information is confidential.²⁹¹ To be sure, the possibility of a high profile criminal prosecution or media attention to the tactics of publicly traded corporations will focus attention on reputational harm. Starbucks' recent decision to move its European headquarters to the United Kingdom in the aftermath of consumer protests over its paltry contribution to the U.K. treasury is a case in point.²⁹² However, such cases are aberrational.

Tax evasion made possible by secret foreign financial accounts is a serious problem. In 2012, the Tax Justice Network estimated that between \$21 and \$32 trillion in wealth is held in offshore accounts.²⁹³ Disparities between the growth of income and the growth of wealth for wealthy U.S.

Behavioralist As Tax Collector: Using Natural Field Experiments to Enhance Tax Compliance (Nat'l Bureau of Econ. Research, Working Paper No. 20007, 2014).

²⁹¹ Tax returns and tax return information were made confidential in the aftermath of the Watergate scandal and the Nixon administration's enlistment of the IRS to further its political goals. *See* I.R.C. § 6103(a) (2012). *See also supra* note 98. Statutory exceptions to the confidentiality requirement are scarce and include limited disclosures for state tax and state and local law enforcement, disclosures to committees of Congress, disclosures for statistical use, disclosures pursuant to presidential requests, and confirmation of presidential appointees to executive and judicial branch positions. I.R.C. § 6103(d), (f), (g)(1)-(2), (j). Willful unauthorized disclosures are punishable by fines, incarceration, and dismissal from office. *Id.* § 7213(a). Civil actions may also be brought against the United States for knowing or negligent unauthorized disclosures. *Id.* § 7431(a)(1). Moreover, anti-browsing provisions were enacted in response to evidence that IRS employees were browsing taxpayer records for no legitimate purpose. *Id.* § 7213A(a). In addition to the confidentiality requirements imposed on the government, much tax advice will be protected from disclosure by attorney-client privilege, work product doctrine protection, and ethical requirements. *See, e.g.,* MODEL RULES OF PROF'L CONDUCT r. 1.6 (2014); MODEL CODE OF PROF'L RESPONSIBILITY DR 4-101 (1980). Privilege has been extended to accountants and other practitioners before the IRS. I.R.C. § 7525.

²⁹² *See* Peter Evans, *Starbucks to Move Europe Base to U.K.*, WALL ST. J., Apr.17, 2014, at B6 (east ed.). Apple made a different reputational assessment. Apple had a highly publicized run-in with a congressional committee over its aggressive tax avoidance practices. Unlike Starbucks, Apple vigorously defended its practices. *See* Janet Hook & Danny Yadron, *Apple CEO, Lawmakers Square Off Over Taxes*, WALL ST. J., May 22, 2013, at A1 (east ed.).

²⁹³ *See* JAMES S. HENRY, TAX JUSTICE NETWORK, THE PRICE OF OFFSHORE REVISITED 5 (2012). The number of FBAR filings has increased significantly in the past decade. In 2004, almost 218,000 reports were filed whereas 780,000 were filed in 2012. *See* Morse, *supra* note 278, at 701; Agency Information Collection Activities; Comment Request of the Proposed Changes to the Report of Foreign Bank and Financial Accounts Report, 78 Fed. Reg. 14,415, 14,416 n.5 (Mar. 5, 2013). However, FBAR filings are significantly less than the number of U.S. citizens living abroad and estimates of other citizens with foreign financial accounts. *See* OFFSHORE TAX EVASION, *supra* note 2, at 22. Based on the latest available statistics, over 43,000 taxpayers participated in the OVDP and paid over \$6 billion in taxes, interest, and penalties. *Id.* at 1.

taxpayers indicate that a significant portion of wealth is hidden offshore.²⁹⁴ The United States expends significant resources and diplomatic capital in arm-twisting the financial services industry and foreign governments to provide it with assistance in combatting tax evasion.²⁹⁵ FATCA is the latest attempt by the United States to enlist third parties to provide it with assistance in the enforcement of its tax laws.²⁹⁶ FATCA includes significant deterrence to noncompliance by foreign financial institutions.²⁹⁷ Moreover, reputational issues may play a significant role at the level of the financial intermediaries and sovereigns. With few exceptions, financial institutions and nations do not welcome the reputation as a haven for tax cheats, money launderers, and other unsavory characters. FATCA and future coordinated attempts by sovereign nations to increase tax compliance may, in time, reduce the need for the draconian penalties now in force.

In the abstract, it is arguable that the harm inflicted by offshore tax evasion includes, in addition to the resulting direct loss of revenue and significant administrative costs, the erosion of faith in the tax system itself and the concomitant effect such erosion has on voluntary compliance. However, individual cases are not abstractions. *Bajakajian* involved similar issues—a reporting regime put in place to buttress tax compliance and ferret out some very deleterious behaviors.²⁹⁸ The Court, however, had to decide whether a particular person in particular circumstances deserved a sanction that, in the abstract, may have been justifiable. Similarly, the FBAR penalties should be analyzed on a case-by-case basis. The existence of separate and harsh civil penalties for tax evasion should not be ignored in the gross disproportionality analysis. Consequently, under appropriate circumstances, these penalties are constitutionally suspect.

In the example above, the taxpayer evaded \$1,247,419 of taxes over a five year period.²⁹⁹ The civil tax penalties for this evasion amount to \$1,348,013.³⁰⁰ In addition, a host of criminal penalties with fines ranging from \$10,000 to \$100,000 may be imposed, as well as up to five years imprisonment.³⁰¹ These totals do not include interest payable on the underpayments. The FBAR penalties amount to \$29,876,593.³⁰² Because the FBAR penalties are based on the balances in the unreported foreign finan-

²⁹⁴ See NICHOLAS SHAXSON ET AL., TAX JUSTICE NETWORK, INEQUALITY: YOU DON'T KNOW THE HALF OF IT 6-9 (2012), available at <http://www.taxjustice.net/wp-content/uploads/2013/04/Inequality-1207-you-dont-know-the-half-of-it.pdf>.

²⁹⁵ See *supra* notes 11-18 and accompanying text.

²⁹⁶ See *supra* notes 98-117 and accompanying text.

²⁹⁷ See *supra* note 100 and accompanying text.

²⁹⁸ See *supra* note 191-92 and accompanying text.

²⁹⁹ See *supra* note 130 and accompanying text.

³⁰⁰ This figure represents the sum of the cumulative understatement penalties and the cumulative fraud penalties. See *supra* notes 131-32 and accompanying text

³⁰¹ See *supra* notes 122-25 and accompanying text.

³⁰² See *supra* note 134 and accompanying text.

cial accounts, these penalties may only bear a loose relationship to the amount of tax that is unreported. The example above assumed a 6-percent taxable return on the invested funds. A taxpayer whose funds generated a significantly less return—not unusual in today’s interest rate environment—would nonetheless be liable for a comparable FBAR penalty.³⁰³ Moreover, it is possible that any potential increase in a taxpayer’s U.S. tax liability as a result of earnings from foreign investments is substantially reduced due to a host of factors, such as net operating loss carryovers or foreign tax credits.³⁰⁴ Again, this taxpayer would face an identical FBAR penalty. Theoretically, a \$1 understatement in tax per year could generate the \$29,876,593 FBAR penalty.

It is difficult to muster any sympathy for taxpayers who squirrel away funds in foreign accounts in a willful attempt to evade their financial obligations to society. In effect, their obligations are heaved upon current and future law abiding citizens. However, Congress has spoken forcefully and with great specificity with respect to tax evasion by its enactment of civil and criminal tax penalties. It also has made special accommodations with respect to the underpayment of tax due to unreported foreign earnings through the imposition of an enhanced substantial understatement penalty attributable to such unreported earnings.³⁰⁵ Moreover, Congress recently targeted the reporting offense itself through the enactment of the FATCA penalty—a modest \$10,000 penalty.³⁰⁶ Both the enhanced underpayment penalty and the FATCA reporting penalty are the result of recent congressional action, so it cannot be said that these provisions are outdated or that Congress’s action was based on its ignorance of the extent of the tax evasion problem.³⁰⁷

Any gross disproportionality test using the *Bajakajian* factors should be informed by the existence of a separate and robust regime of civil tax evasion penalties. Unlike the respondent in *Bajakajian*, a tax evader is clearly the object of the FBAR reporting regime and the tax evader’s failure

³⁰³ In the above example, the FBAR penalties would be reduced if the account in question earned a reduced rate of return. The example assumed all earnings were reinvested in the account and that no withdrawals were made from the account. Therefore, a reduced rate of return on the funds would reduce the account balance at any point in time thereby resulting in a reduction of the FBAR penalties.

³⁰⁴ See, e.g., I.R.C. §§ 172, 901 (2012). It is unlikely that taxpayers who evade U.S. taxes through the use of foreign accounts will incur foreign taxes with respect to income generated from such accounts. Generally, such accounts reside in tax haven jurisdictions that impose no taxes on such income. However, it is conceivable that, under certain circumstances, foreign taxes are paid on, or withheld from, such income particularly in the case of U.S. citizens who have established residence in a foreign country.

³⁰⁵ The substantial understatement penalty has been doubled, from 20 percent to 40 percent, for underpayments related to unreported foreign income. See *supra* note 131 and accompanying text.

³⁰⁶ See *supra* note 112 and accompanying text.

³⁰⁷ Both FATCA and the heightened understatement penalty were enacted in 2010. See *supra* notes 99, 130 and accompanying text.

to report would be related to another crime. However, in the absence of any other offense, the existence of the separate tax penalties should cause a court to consider the reporting violation as just that—a reporting violation. The enforcement of the FBAR penalties provides ample evidence that the penalties' focus is tax evasion. As noted, no penalty will be imposed if the failure to report is not accompanied by a tax deficiency.³⁰⁸ Moreover, the mitigation provisions are based on the size of the account balances in the unreported accounts indicating that mitigation is based on the potential loss of tax revenue from the failure to report.³⁰⁹ If a significant purpose of the rules is to reduce and ultimately eliminate the disrespect for the tax laws and cultivate a culture of compliance, then such a purpose is belied by a penalty structure that places such emphasis on the amount of tax at issue.

In addition, the reduced penalties offered to taxpayers under the OVDP can be interpreted as a measure of the harm caused by the initial failure to report. In the above example, had the taxpayer participated in the OVDP, the taxpayer would have owed \$3,680,120 in lieu of the \$935,565 civil fraud penalty, the \$30,000 FATCA penalty, and the \$29,876,593 FBAR penalty.³¹⁰ Any statutory penalty in excess of the penalty that would have been imposed after voluntary disclosure can be considered a penalty for continued deceit—an action that, according to the Court, does not alter the reporting offense. The respondent in *Bajakajian* not only failed to report the currency in his possession and in his baggage but also lied to customs officials when questioned. The Court stated that

the nature of the nonreporting offense in this case was not altered by respondent's "lies" or by the "suspicious circumstances" surrounding his transportation of his currency. A single willful failure to declare the currency constitutes the crime, the gravity of which is not exacerbated or mitigated by "fable[s]" that respondent told one month, or six months, later.³¹¹

Arguably, tax evasion on foreign income poses a greater problem for the government than other forms of tax evasion because of the difficulty of its detection.³¹² Other forms of tax evasion have been singled out for harsh

³⁰⁸ See *supra* note 85 and accompanying text.

³⁰⁹ The various levels of mitigation are based on the size of the account balances in question. See *supra* notes 58-62 and accompanying text.

³¹⁰ See *supra* note 136 and accompanying text. Under certain circumstances the penalties imposed under the OVDP can exceed the statutory penalties. In such circumstances, the statutory penalties are imposed. See *supra* note 79.

³¹¹ *United States v. Bajakajian*, 524 U.S. 321, 337 n.12 (1998) (alteration in original) (citation omitted).

³¹² Arguably, this form of tax evasion is more accessible to taxpayers with funds derived from legitimate sources than other forms of tax evasion. Most taxpayers do not derive their principal income from unreported cash sources and have neither the ability nor the desire to enter into complex transactions designed to evade tax. Tax evasion through the use of foreign accounts is relatively simple.

treatment—tax shelters and overvaluations of property, for example.³¹³ However, the harsh treatment meted out for what Congress considered particularly insidious forms of tax avoidance were meted out through the tax code. Congress has done the same for unreported income from foreign accounts. The FBAR and FATCA rules are attempts to ease the government's enforcement burden through taxpayer reporting and third party assistance. No doubt these rules serve an important purpose. Tax evasion is punished and it is punished harshly.

Criminal sanctions for an offense are an appropriate metric in assessing the seriousness of the offense in question. The use of separate and distinct civil sanctions for a separate, yet related, offense in a similar manner tends to eviscerate Eighth Amendment safeguards. The penalties, as currently structured, penalize the reporting offense significantly more harshly than the offense for which the reporting rules were designed to deter. This result is counterintuitive. Civil sanctions for the tax offense should not be used as cover for the imposition of draconian penalties for the reporting offense. The gross disproportionality test should distinguish between a taxpayer who funded the unreported accounts with the proceeds of illegal activities or who used the funds in such accounts to further illegal enterprises from a taxpayer who funded the accounts with funds from legitimate sources. To be sure, the latter taxpayer deserves some punishment for both the failure to report and the tax evasion made possible by such failure. In the above example, the latter offense is punished by fines of approximately \$1,348,000, an amount in excess of 100 percent of the tax due.³¹⁴ It strains credulity that a fine approaching \$30,000,000 bears any semblance of proportionality to the reporting offense. After all, the reporting rules were designed to prevent the tax evasion. A greater than twenty-fold multiple of punishment for the former relative to the latter appears excessive. FATCA punishes the reporting violation in a measured manner. The FBAR rules do not.

CONCLUSION

Tax evasion contributes to the mind-numbing size of the U.S. debt, exacerbates the growing inequality of wealth in the United States, and burdens law-abiding citizens whose tax bills compensate for the revenues lost

³¹³ For example, a tax understatement due to tax shelters, in contrast to other tax understatements, is not reduced by taxpayer disclosure. *See* I.R.C. § 6662(d)(2)(C) (2012). Moreover, certain tax shelter transactions must be reported and significant penalties may be imposed on tax shelter promoters. *See id.* §§ 6700, 6707A. Understatements of tax due to gross valuation misstatements are penalized at 40 percent, similar to the penalties imposed on tax understatements due to unreported foreign financial accounts. *See id.* § 6662(h).

³¹⁴ *See supra* notes 299-300 and accompanying text.

from tax evasion. Punishment for tax evasion should be harsh, swift, and certain. That said, the Eighth Amendment limits the ability of the government to punish even the most egregious offenses. Throughout its history, the Supreme Court has had relatively little to say about the Eighth Amendment's Excessive Fines Clause. Recently, however, it has had occasion to visit this issue and, in deference to the legislative branch and its admitted lack of expertise in the harms that emanate from illicit practices, has interpreted the Excessive Fines Clause to permit all fines that are not grossly disproportionate to the offenses for which they are imposed. FBAR penalties, which can amount to many multiples of both the balances in unreported foreign financial accounts and the tax evaded on the income from such accounts, are susceptible to an Eighth Amendment challenge. A harsh and comprehensive penalty regime for tax evasion and the significant reduction in penalties for participants in the voluntary disclosure program indicate that maximum FBAR penalties are grossly disproportionate to the reporting offense for which they are imposed. Tax evaders garner very little sympathy and rightly so. However, constitutional protections were designed, in large part, to protect those for whom little sympathy could be expected from elected officials.