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

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Penalties for the Failure to Report Foreign Financial Accounts and the Excessive Fines Clause of the Eighth Amendment

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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.

The Economist‡

...[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.

Kathryn Keneally†

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

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† Laura Saunders, The Next Offshore Target, WALL ST. J., at B9 ( quoting Assistant Attorney General Kathryn Keneally )
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 ( 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 wealthy brothers used a complex web of offshore accounts to avoid disclosure obligations under the securities law and to assist their insider trading activity).
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.\textsuperscript{3}

The government has employed various methods in its efforts to combat tax evasion that is 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 that fail to meet their obligation to disclose the existence of foreign financial accounts. The Eighth Amendment proscribes the imposition of excessive fines by the government. Surprisingly, the Supreme Court has provided relatively little guidance in the determination of 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 (I.R.S.) 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.

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 disproportionately 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 informed by 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. Part IV concludes.

I. FOREIGN FINANCIAL ACCOUNT REPORTING RULES

A. In General

The Banks Records and Foreign Transactions Act, better known as the Bank Secrecy Act, was enacted in 1970 in an effort to combat money laundering and tax evasion. 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 obligation on such institutions. Numerous amendments were made to the Act over the years in order to strengthen efforts to combat money laundering and, more recently, to aid in counterterrorism activities. As discussed in detail subsequently, statutory duties were not limited to those imposed on financial institutions. The legislation also imposes certain reporting obligations on foreign financial account holders and recent tax legislation imposes an additional, albeit somewhat related,

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7 See infra notes 17-33 and accompanying text.
reporting duty on such account holders. 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. The identification of U.S. taxpayers who evade the payment of U.S. income taxes through the use of offshore accounts is accomplished by U.S. authorities through a variety of means. 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. The United States attempts to include in tax treaties and tax information exchange agreements information exchange provisions that encompass any information relevant for carrying out the provisions of U.S. tax law.

The United States, in addition to enlisting foreign tax authorities in her 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 thirty 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. More recently, 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

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8 See infra notes 95-114 and accompanying text.
9 Switzerland is not the exclusive recipient of the I.R.S.’s attention. The agency recently has begun to focus significant investigative resources on the Cayman Islands. See Laura Saunders, The Next Offshore Target, WALL ST. J., April 5, 2014, at B9.
12 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 which included the fact that qualified intermediaries did not have to report the identities of non-U.S. clients to the I.R.S. 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. §§ 1.6042-3(b)( 2000 ); 1.6045-1(a)(1)( 2013 ); 1.6049-5(b)(6)( 2012 ). 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 MGMT. INT’L J. 331, 331-33 (1998).
controlled by U.S. persons. Failure to do so will cause the offending institution to incur a thirty percent withholding tax on all investment income received from U.S. sources. Predictably, FATCA has been subject to criticism as a unilateral and extraterritorial enlistment of foreign financial institutions as de facto Treasury agents. Finally, taxpayer cooperation in providing

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14 Hiring Incentives to Restore Employment Act, § 501, 124 Stat. at 97-106 (codified at I.R.C. §§ 1471-74). Disclosures may be made through bilateral agreements between the foreign financial institutions and the United States or through an intergovernmental agreement. See generally Notice 2013-69, 2013-46 I.R.B. 503; 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, 26 nations have executed intergovernmental agreements and an additional 19 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 (April 2, 2014) available at http://www.treasury.gov/press-center/press-releases/Pages/jl2343.aspx. FATCA also contains taxpayer disclosure requirements. See infra notes and accompanying text. Foreign financial institutions have had difficulty in their FATCA compliance efforts. See Lynneley Browning, Complying with U.S. Tax Evasion Law is Vexing Foreign Banks, N.Y. TIMES, Sept. 17, 2013, at B6. The I.R.S. 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 Notice 2014-33, 2014 I.R.B. LEXIS 327 (May 2, 2014). See also John D. McKinnon & Eyk Henning, Banks Get Break on New Tax-Evasion Enforcement, WALL ST. J., May 3, 2014, at A1. 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.
15 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 47 countries and the European Union declared their support for a single global information sharing protocol. See Org. Econ. Cooperation & Dev., Declaration on
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 therefrom.  

B. 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 Bank Secrecy Act and the regulations issued thereunder, commonly referred to as the FBAR rules, require that each United States person having a financial interest in, or signature authority over, bank, securities, or other financial accounts in a foreign country whose aggregate value exceeds $10,000 to file a Report of Foreign Bank and Financial Accounts with the I.R.S.

Responsibility for the administration of FBAR reporting is now shared by the Secretaries of the Treasury and the Attorney General. The Financial Crimes Enforcement Network (FinCEN) in the Treasury Department is responsible for the administrative aspects of FBAR reporting. FinCEN has issued regulations requiring each United States person having a financial interest in, or signature authority over, financial accounts in foreign countries whose aggregate value exceeds $10,000 to file a Report of Foreign Bank and Financial Accounts with the I.R.S.

Various provisions of the Bank Secrecy Act were codified in Title 31 of the United States Code in 1982. See History of the Bank Secrecy Act, supra note 6, at C7-C8. The required information was reported, until recently, on Form TD-F-90.22.1, Report of Foreign Bank and Financial Accounts, on or before June 30 of the year following the reporting year. 31 C.F.R. § 1010.350(a)(2011). This report was not filed with an income tax return but as 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 FinCEN Notice, Important Notice to BSA E-Filers: Updated Report of Foreign Bank and Financial Accounts (FBAR), FBAR Batch Capability, and Web Site Updates (Sept. 30, 2013), available at http://www.fincen.gov/whatsnew/html/20130930.html. A person having a financial interest in, or signature authority over, 25 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) (2011). 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 Possessions of the United States. 31 C.F.R. §§ 1010(hhh); 1010.350(h)(1011). 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


16 See infra note 76 and accompanying text.

17 31 U.S.C. § 5314 (2010); 31 C.F.R. §§ 1010.306(c); 1010.350(a)(2011). Various provisions of the Bank Secrecy Act were codified in Title 31 of the United States Code in 1982. See History of the Bank Secrecy Act, supra note 6, at C7-C8. The required information was reported, until recently, on Form TD-F-90.22.1, Report of Foreign Bank and Financial Accounts, on or before June 30 of the year following the reporting year. 31 C.F.R. § 1010.350(a)(2011). This report was not filed with an income tax return but as 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 FinCEN Notice, Important Notice to BSA E-Filers: Updated Report of Foreign Bank and Financial Accounts (FBAR), FBAR Batch Capability, and Web Site Updates (Sept. 30, 2013), available at http://www.fincen.gov/whatsnew/html/20130930.html. A person having a financial interest in, or signature authority over, 25 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) (2011). 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 Possessions of the United States. 31 C.F.R. §§ 1010(hhh); 1010.350(d)(2011). 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
rests with the Financial Crimes Enforcement Network (FinCEN), a bureau of the Department of the Treasury, although the I.R.S. has a significant role in the policing of these rules under a Memorandum of Understanding issued in 2003. For this purpose, a United States person is a citizen or resident of the United States and 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. 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. A securities account is an account maintained with a person engaged in the business of buying, selling, holding or trading stock or other securities. 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, accounts with brokers or dealers in commodity options or futures, the United states – so-called omnibus accounts – are not subject to reporting provided that the holder of the account cannot access her foreign holdings directly. See Preamble, Amendments to the Bank Secrecy Act Regulations – Reports of Foreign Financial Accounts, 76 Fed. Reg. 10235 (Feb. 24, 2011). FATCA also requires taxpayers to provide information that is filed with the income tax return. See infra notes 98-99 and accompanying text.

18 See 31 C.F.R. § 103.56(g) (2003).
19 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) (CCH 2014). For purposes of determining residency status, the United States is defined pursuant to 31 C.F.R. §§ 1010(hhh), set forth at supra note , and not by the regulations promulgated under I.R.C. § 7701. See 31 C.F.R. § 1010.350(b)(2) (2011). Individuals who elect resident status are subject to the reporting requirements only during the period for which the election is effective. Preamble, Amendments to the Bank Secrecy Act Regulations – Reports of Foreign Financial Accounts, 76 Fed. Reg. 10238 (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) (CCH 2014). 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 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) (2010). The term “financial institution” has been given a broad interpretation. See United States v. Dela Espriella, 781 F.2d 1432, 1436-37 (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, 2014 U.S. Dist. LEXIS 77489, at *8-*11( N.D. Ca. 2014). The reporting obligation with respect to life insurance policies resides with the owner of the policy and not the beneficiary of the policy. Preamble, Amendments to the Bank Secrecy Act Regulations – Reports of Foreign Financial Accounts, 76 Fed. Reg. 10239 (Feb. 24, 2011).
and mutual funds available to the general public with a regular net asset value determination and redemption feature, or similar pooled funds.  

A United States 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. In addition, a financial interest exists for any United States 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 such person. Several entity attribution rules exist that establish a financial interest in a United States person. First, financial interests owned by a corporation or a partnership are deemed the financial interests of direct or indirect owners of more than fifty percent of the voting power of the corporation or more than fifty percent of the interests in the profits or capital of the partnership. Similar rules apply to any other entity in which a United States person owns more than fifty percent of the voting power, equity, assets, or profit interests. 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. Likewise, trust beneficiaries possessing a more than fifty percent present beneficial interest

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23 31 C.F.R. § 1010.350(c)(3)(i)-(iv)(A) (2011). Accounts of a department or agency of the United States, Indian tribes, and any state or political subdivision thereof, or any wholly-owned entity, agency, or instrumentality of any of the foregoing are excluded from the definition of foreign financial accounts. 31 C.F.R. § 1010.350(c)(4)(i) (2011). 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. 31 C.F.R. § 1010.350(c)(4)(ii)-(iv) (2011). The regulations have reserved guidance on the applicability of the reporting rules with respect to other foreign commingled funds. 31 C.F.R. § 1010.350(c)(4)(B) (2011). The I.R.S. announced that it will not enforce the reporting rules with respect 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 Notice 2010-23, 2010-1 C.B. 441.

24 31 C.F.R. § 1010.350(e)(1) (2011). 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 United States person is living abroad is irrelevant to whether that person has a reporting obligation. An account maintained in the name of more than one United States person will trigger multiple reporting obligations because each named person would have a financial interest in the account.


27 Id. An entity that owns directly or indirectly more than a 50 percent interest in one or more entities may file a consolidated report on behalf of itself and such other entities. 31 C.F.R. § 1010.350(g)(3) (2011).

28 31 C.F.R. § 1010.350(e)(2)(iii) (2011). 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 corpus or the income therefrom, has certain rights to income
interest in the assets or income of the trust are considered to have a financial interest in the accounts of the trust. The regulatory language is somewhat cryptic as to whether the aforementioned 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.

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. 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. 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 reporting obligations mitigates the possibility that a person with a financial interest in the account fails to report.

2. Penalties

from the trust, or has certain reversionary interests. See generally I.R.C. §§ 671-679 ( CCH 2014 ).

31 C.F.R. § 1010.350(e)(2)(iv)( 2011 ). 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. 31 C.F.R. § 1010.350(f)(5) ( 2011 ).

See id.

31 C.F.R. § 1010.350(f)(1) ( 2011 ). 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. 31 C.F.R. § 1010.350(f)(2) ( 2011 ). 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. 31 C.F.R. § 1010.350(g)(4) ( 2011 ). Participants in other types of retirement plans will be subject to reporting under the entity attribution rules discussed at supra notes 26-29 and accompanying text.


33 Id. at 10236.
The American Jobs Creation Act of 2004 greatly increased the penalties for the failure to timely disclose foreign financial accounts. 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 such duties. According to the Supreme Court “[w]illfulness . . . requires Government to prove that the law imposed a duty on the defendant, that the defendant knew that duty. . . . Carrying this burden requires negating a defendant’s claim of ignorance of the law . . . .” 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 not to exceed $100,000.

The 2004 legislation increased the penalty for willful violations of the reporting obligations to the greater of $100,000 or fifty percent of the balance of the account at the time of the violation. Moreover, non-willful violations are subject to penalties not to exceed $10,000. Civil penalties may be imposed notwithstanding the imposition of criminal penalties. The statutory language provides that the I.R.S. “may” impose a penalty for non-willful violations thereby indicating that a modicum of discretion is provided to the agency in dealing for non-willful violations. Moreover, the fact that the statute establishes a maximum penalty indicates that the I.R.S. has the discretion to impose either no penalty or a penalty of less than $10,000 for non-willful violations. The I.R.S. has indicated that it will, in fact, exercise discretion in dealing

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37 31 U.S.C. §§ 5321(a)(5)(C)(i); 5321(a)(5)(D)(ii) (2010). 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. I.R.M. § 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)(2010).
38 31 U.S.C. § 5321(a)(5)(B)(i) (2010). 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. 31 U.S.C. § 5321(a)(5)(B)(ii) (2010). An additional penalty for negligence may be imposed on financial institutions or non-financial trades or businesses. See 31 U.S.C. § 5321(a)(6) (2010).
39 31 U.S.C. § 5321(d) (2010). Criminal penalties of up to $250,000 in fines and imprisonment for no more than five years may be imposed. See 31 U.S.C. § 5322(a) (2010). 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. See 31 U.S.C. § 5322(b) (2010).
40 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, 735 (2001).
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.\textsuperscript{41} Such persons should file late reports prior to being notified that they are under examination.\textsuperscript{42}

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.\textsuperscript{43} 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 Bank Secrecy Act 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 a criminal purposes, the person must have cooperated with the I.R.S. during the examination, and no civil tax fraud penalty for underpayment of income tax could have been sustained against the taxpayer.\textsuperscript{44} 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.\textsuperscript{45} If the aggregate highest balances 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.\textsuperscript{46} If the aggregate highest balance in all foreign financial accounts for the year in question exceed $50,000 but is less than $250,000 then the penalty for each violation is the lesser of $5000 or ten percent of the highest balance in the account during the year for which the account should have been reported:\textsuperscript{47}

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.\textsuperscript{48} 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 the taxpayer to indicate whether she has an interest in foreign accounts but does not require the reporting of the balance in any such account.\textsuperscript{49} 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

\begin{itemize}
\item \textsuperscript{41} See infra note 83 and accompanying text.
\item \textsuperscript{42} Id.
\item \textsuperscript{43} I.R.M. \textsection 4.26.16.4.( July 1, 2008 ).
\item \textsuperscript{44} I.R.M. \textsection 4.26.16.4.6.1.( July 1, 2008 ).
\item \textsuperscript{45} I.R.M. \textsection 4.26.16.4.6.2.( July 1, 2008 ).
\item \textsuperscript{46} Id.
\item \textsuperscript{47} 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 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 69.
\item \textsuperscript{48} See supra note 38.
\item \textsuperscript{49} See infra note 50.
\end{itemize}
failure to file the required report and the inclusion on the taxpayer’s income tax return of any taxable income from such accounts.\(^50\)

In addition to the exercise of discretion with respect to the assessment of penalties for non-willful violations, the I.R.S. has also indicated that the exercise of discretion may be appropriate with respect to the imposition of willfulness penalties. According to the I.R.S. willfulness is shown by a person’s knowledge of, and conscious choice not to comply with, the foreign financial account reporting requirements.\(^51\) 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.\(^52\) By way of examples, the I.R.S. has indicated that the failure to answer a question regarding foreign financial accounts on an income tax return 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.\(^53\) A willfulness penalty is not imposed if the failure to report was due to reasonable cause.\(^54\) Presumably, this exception should apply only in 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 the income from which was properly reported on an income tax return may not warrant a finding of willfulness.\(^55\)

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.\(^56\) 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 five percent of the maximum account balance for each unreported account during the calendar year.

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\(^50\) What is reasonable cause for this purpose is not expressly defined. The I.R.S. has indicated that the reasonable cause exceptions to the accuracy related penalties imposed by I.R.C. § 6662 may provide guidance. I.R.M. § 4.26.4.3.1 (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 2013 Form 1040, U.S. Individual Income Tax Return, Schedule B, Part III, Foreign Accounts and Trusts. 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.

\(^51\) I.R.M. § 4.26.16.5.3 (July 1, 2008).

\(^52\) Id.

\(^53\) Id.

\(^54\) Id.

\(^55\) See Id.

\(^56\) I.R.M. § 4.26.16.4.6.3 (July 1, 2008). See also supra note 44 and accompanying text.
year.\textsuperscript{57} 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 ten percent of the maximum account balance for each unreported account during the calendar year.\textsuperscript{58} 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 ten percent of the maximum account balance for each unreported account during the calendar year or fifty percent of the closing balance in the account as of the last date for filing the required report.\textsuperscript{59} 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.\textsuperscript{60}

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 United States 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, the partnership itself has a reporting obligation.\textsuperscript{61} In addition, any partner who holds a greater than fifty 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.\textsuperscript{62} Therefore, in the event that no member of the club held a greater than fifty percent interest in the capital or profits of the club, only the partnership and its members or other persons with signature authority 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.\textsuperscript{63} 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.\textsuperscript{64} 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.\textsuperscript{65} 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

\textsuperscript{57} I.R.M. § 4.26.16.4.6.3 ( July 1, 2008 ).
\textsuperscript{58} Id.
\textsuperscript{59} Id.
\textsuperscript{60} Id. Separate mitigation provisions apply to cases closed under the Last Chance Compliance Initiative. See infra note 69.
\textsuperscript{61} See supra note 19 and accompanying text.
\textsuperscript{62} See supra notes 17,26, 31-32 and accompanying text.
\textsuperscript{64} Treas. Reg. § 1.761-2(a)(2) (1994 ).
\textsuperscript{65} 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 ).
account. 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, a family member or agent, for example or for accounts that are jointly held. 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 such account. 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.

C. Offshore Voluntary Disclosure Program

On January 9, 2012 the I.R.S. announced the institution of the Offshore Voluntary Disclosure Program (OVDP). This program succeeded several other voluntary disclosure programs. This program is open for an indefinite period. The objective of the program is to

66 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 in her own behalf with respect to the account but also as an agent for the other members. See supra note 25 and accompanying text.

67 See supra note 41 and accompanying text.


69 The I.R.S. instituted the Offshore Voluntary Disclosure Initiative in 2011. See Second Special Voluntary Disclosure Initiative Opens; Those Hiding Assets Offshore Face Aug. 31 deadline, Information Release 2011-14, available at http://www.irs.gov/uac/Second-Special-Voluntary-Disclosure-Initiative-Opens%3B-Those-Hiding-Assets-Offshore-Face-Aug.-31-deadline. This program succeeded the 2009 Offshore Voluntary Disclosure Program an overview of which is available at http://www.irs.gov/pub/newsroom/overview_en.pdf. 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; Letter 3649 (Rev. 6-2003) available at http://famguardian.org/TaxFreedom/Responding/FederalCorr/DirectLetters/IRS-LTR3649.pdf. 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.

encourage voluntary compliance by taxpayers with respect to the reporting of foreign assets and the payment of tax on the income therefrom. Encouragement 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. The voluntary disclosure period is the most recent eight years for which the due date of the return has already passed. Taxpayers must make timely, truthful, and complete disclosures and cooperate with the I.R.S. in its determination of the taxpayer’s correct tax liability. Disclosure is not timely if it made after the taxpayer is under examination or under criminal investigation. Moreover, a participating taxpayer must cooperate with I.R.S. offshore enforcement efforts by providing, if requested, information about offshore financial institutions, offshore service providers, and other facilitators and notify the Justice Department if she has appealed a foreign tax official’s decision that authorizes the provision of account information to the I.R.S.

The offshore penalty is 27.5 percent of all foreign assets that relate to tax non-compliance. 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 generate income for which tax was due but not paid. 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. A five percent penalty is applied in certain limited circumstances – generally in cases that the account in question was not opened by the taxpayer, required information is submitted taxpayers will obtain a preliminary acceptance into the program. The procedural details of the program are discussed at id, FAQs 22-30.

Id., FAQ 2.

Id., 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.

Id., FAQs, supra note 70, FAQ 9.

Id., FAQs 7, 7.1.

Id., FAQs 14.


Id., 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 than 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., FAQ 50.

Id., FAQ 35.

Id., FAQ 53.
minimal withdrawals were made from the account, and the taxpayer had minimal and infrequent contact with the account.\textsuperscript{80}

If a taxpayer is compliant with the requirements of the program then the I.R.S. will not recommend criminal prosecution of the taxpayer to the Department of Justice.\textsuperscript{81} 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.\textsuperscript{82} Moreover, such “quiet disclosures” do not avoid penalties for FBAR reporting failures. Hence, if a taxpayer 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.\textsuperscript{83} 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.\textsuperscript{84} In addition, such taxpayers must consider the effect that the mitigation provisions, if applicable, would have on their potential exposure notwithstanding the OVDP.\textsuperscript{85}

Of course, the potential for criminal prosecution may overwhelm these other factors. Fortunately, the OVDP allows taxpayers to opt out of the program.\textsuperscript{86} 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.\textsuperscript{87}

Effective 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

\textsuperscript{80} Id., 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. \textit{See id.}

\textsuperscript{81} Id., FAQ 3.

\textsuperscript{82} Id., FAQ 15.

\textsuperscript{83} Id., FAQ 17.

\textsuperscript{84} \textit{See supra} note 37. 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. § 6051(a) (CCH 2014 ). 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. I.R.C. § 6051(e)(1) (CCH 2014 ). 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. I.R.C. § 6051(c)(1)-(3) (CCH 2014 ). Taxpayers may agree to extend the statute of limitations for assessment or collection of tax. I.R.C. § 6051(c)(4) (CCH 2014 ). Taxpayers must agree to the extension of the statute of limitations to participate in the OVDP. \textit{Id.}, FAQ 42.

\textsuperscript{85} \textit{See supra} notes 44-60 and accompanying text.

\textsuperscript{86} OVDP FAQs, \textit{supra} note 70, FAQ 51.

\textsuperscript{87} \textit{Id.}, FAQ 51.1.
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 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. Moreover, the reduced penalties available under certain circumstances have been eliminated due to the expansion of the streamlined filing compliance procedures. Prior to the revisions, U.S. citizens residing abroad who were deemed low compliance risk could submit their information under a streamlined process and would not be assessed penalties. 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. The I.R.S. 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 due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law. 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 five percent of the taxpayers’ highest aggregate account balances. 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 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. 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 in effect a reporting regime that complements, but differs in several respects from, the FBAR requirements. FATCA was enacted as part of Title V of the Hiring Incentives to Restore Employment Act. As previously noted, this legislation mandates that foreign financial institutions provide certain information to U.S. tax authorities or face tax withholding on income that they derive from sources within the United States. In addition, FATCA added section 6038D to the Internal Revenue Code that, effective for taxable years beginning after March 18, 2010, imposes an annual foreign asset reporting requirement on


95 The FBAR rules have their genesis in the banking law and, therefore, the I.R.S. 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 I.R.S. to further its political goals, tax returns and tax return information were made confidential. See I.R.C. § 6103(a) ( CCH 2014 ). 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);6103(d); 6103(f); 6103(j); 6103(g)(1)-(2) ( CCH 2014 ). Willful unauthorized disclosures are punishable by fines, incarceration, and dismissal from office. I.R.C. § 7213(a) ( CCH 2014 ). Civil actions against the United States may also be brought for knowing or negligent unauthorized disclosures. I.R.C. § 7431(a)(1) ( CCH 2014 ). The FATCA reporting obligation is mandated under the Internal Revenue Code and, therefore, no such restrictions apply to the I.R.S. in its enforcement of these rules. See Treas. Inspector Gen. for Tax Admin., New Legislation Could Affect Filers of the Report of Foreign Bank and Financial Accounts, But Potential Issues are Being Addressed 8, available at http://www.treasury.gov/tigta/auditreports/2010reports/201030125fr.pdf ( Sept. 29, 2010 ).


97 See supra notes 13-15 and accompanying text.
individuals and specified domestic entities. This reporting requirement is met by the filing of Form 8938 with the taxpayer’s income tax return. Unlike the FBAR rules, FATCA reporting obligations are imposed only upon individuals and specified domestic institutions.

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. These threshold amounts are doubled for married taxpayers that file a joint return. 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 account that are, or could be, made are, or would be,
required to be reported or otherwise reflected by the taxpayer on his tax return. 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. Unlike the FBAR rules, record ownership, legal title, or signature authority is not determinative of whether a taxpayer has an interest in an account.

Specified financial accounts are financial accounts maintained by a foreign financial institution, stocks or securities issued by a person other than a United States person, financial contracts or instruments whose issuer or counterparty is other than a United States person – for example, derivative contracts - and an interest in a foreign entity. 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 to the FATCA rules. 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.

The penalty for failure to meet the FATCA reporting obligation with respect to any taxable year is $10,000. Additional penalties are imposed if the failure to report continues for more than ninety days after notification of such failure by the I.R.S. The additional penalties are $10,000 per month for failure to report after the expiration of the 90 day period described above, limited to a maximum additional penalty amount of $50,000. This penalty, unlike the FBAR penalties, is not account-based. No penalty may be imposed if the failure to report is due to reasonable cause and not to willful neglect. 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.

2. General Tax Penalties

In addition to the penalties imposed with respect to the failure 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 forty percent of the amount of any underpayment of tax attributable to any transaction

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104 Id.
105 See supra notes 25-33 and accompanying text.
106 I.R.C. § 6038D(b) ( CCH 2014 ).
107 See supra notes 31-33 and accompanying text.
108 See supra notes 20-23 and accompanying text.
111 Id.
112 See supra notes 37-39 and accompanying text.
113 I.R.C. § 6038D(g) ( CCH 2014 ).
114 Id.
involving an undisclosed foreign financial asset.\textsuperscript{115} 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.\textsuperscript{116} Moreover, any underpayment of tax due to fraud is subject to a penalty equal to seventy-five percent of the underpayment which is attributable to fraud.\textsuperscript{117}

Various criminal sanctions set forth in the Internal Revenue Code may also be imposed.\textsuperscript{118} These sanctions are in addition to the criminal sanctions that may be imposed under Title 31 for violations of the FBAR rules.\textsuperscript{119} 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, not more than imprisonment for five years, or both.\textsuperscript{120} 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, not more than imprisonment for one year, or both.\textsuperscript{121} 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, up to three years imprisonment, or both.\textsuperscript{122} Finally, the willful filing of a fraudulent or false return is subject to a fine of not more than $10,000, not more than imprisonment for one year, or both.\textsuperscript{123}

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 six percent per

\begin{itemize}
\item \textsuperscript{115} I.R.C. §§ 6662(b)(7); 6662(j)( CCH 2014 ). 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 supra note and accompanying text.
\item \textsuperscript{116} I.R.C. § 6662(j)(2)( CCH 2014 ).
\item \textsuperscript{117} I.R.C. § 6663(a)( CCH 2014 ). 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. I.R.C. § 6663(b)( CCH 2014 ). There is no statute of limitations on the assessment of tax if the underpayment of tax is due to fraud. See supra note 84.
\item \textsuperscript{118} 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 ( CCH 2014 ). However, for various offenses, including several relevant here, the statute of limitations is six years after the commission of the offense. See id.
\item \textsuperscript{119} 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)( 2010 ). 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. 31 U.S.C. § 5322(b)( 2010 ).
\item \textsuperscript{120} I.R.C. § 7201 ( CCH 2014 ).
\item \textsuperscript{121} I.R.C. § 7203 ( CCH 2014 ).
\item \textsuperscript{122} I.R.C. § 7206 ( CCH 2014 ).
\item \textsuperscript{123} I.R.C. § 7207 ( CCH 2014 ).
\end{itemize}
annum compounded annually and no income taxes were withheld or otherwise imposed by the foreign jurisdiction on the earnings generated by the account. 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:

<table>
<thead>
<tr>
<th>Taxable Year</th>
<th>Taxable Income</th>
<th>Ending Account Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$600,000</td>
<td>$10,600,000</td>
</tr>
<tr>
<td>2010</td>
<td>$636,000</td>
<td>$11,236,000</td>
</tr>
<tr>
<td>2011</td>
<td>$674,160</td>
<td>$11,910,160</td>
</tr>
<tr>
<td>2012</td>
<td>$714,610</td>
<td>$12,624,770</td>
</tr>
<tr>
<td>2013</td>
<td>$757,486</td>
<td>$13,382,256</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Taxable Year</th>
<th>Income Tax Due</th>
<th>§ 6662 Understatement Penalty</th>
<th>§ 6663 Fraud Penalty</th>
<th>FATCA Penalty</th>
<th>FBAR Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
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<td>2012</td>
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<tr>
<td>2013</td>
<td></td>
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</tr>
</tbody>
</table>

124 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 I.R.C. §§ 901-09 ( CCH 2014 ). 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.

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

126 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.

127 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 ( 2012 )( codified at I.R.C. § 1 ). The Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1402(a)(1), 124 Stat. 1029, 1060-63 ( 2010 )( codified at I.R.C. § 1411 ) 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); 1411(b) ( CCH 2014 ). 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.
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  $328,749  $131,500  $246,562  $10,000  $6,691,128

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. Had the taxpayer been accepted in the OVDP program and complied with its requirements he would owe the tax, any interest on such tax, and the $412,448 in understatement penalties but would owe no civil fraud, FATCA, or FBAR penalties. In lieu of these penalties an offshore penalty of $3,680,120 would be imposed. 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*, a jury recently returned a verdict upholding three years of maximum penalties imposed on a taxpayer. The defendant is

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128 *See supra* notes 115-16 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, § 512(a)(2), 124 Stat. at 110-11, (codified at I.R.C. § 6662(j)).

129 The civil fraud penalty is 75 percent of the underpayment of tax attributable to fraud. *See supra* note 117 and accompanying text.

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

131 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 37 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.

132 Interest also may be imposed on the penalties in certain circumstances. *See generally* I.R.C. §§ 6601(a); 6601(e)(2)( CCH 2014 ). *See supra* notes 120-23 and accompanying text for a discussion of the criminal penalties that may be applicable.

133 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 77 and accompanying text.


challenging the constitutionality of the fines on Eighth Amendment grounds. 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.” 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.

In *Browning-Ferris Industries of Vermont, Inc. v. Kelco Disposal, Inc.*, 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’ 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. A jury awarded Kelco $51,146 in compensatory damages and $ 6 million in punitive damages. 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. The Second Circuit affirmed the judgment of the district court and noted 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.

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

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137 U.S. CONST. amend. VIII.
139 *Id.* at 260-61.
140 *Id.* at 262.
141 *Id.*
142 *Id.*
exclusively, to criminal prosecutions and punishments.” However, in this case the Court expressly refused to narrow the confines of the Excessive Fines Clause to criminal punishments. 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.” 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. The Court found the petitioners’ analogy inapposite primarily because such amercements were paid directly to the Crown.

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. 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 that the mischief which gave it birth.” 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 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.

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. The issue before the Court in Austin v. United States was whether the Eighth Amendment applied to in rem civil forfeitures authorized by federal narcotics laws. The petitioner was indicted on multiple counts of violating South Dakota’s drug laws. State law enforcement

143 Id. at 262-63 (citing Ex parte Watkins, 7 Pet. 568, 573-74 (1833); Fong Yue Ting v. United States, 149 U.S. 698, 730 (1893); Ingraham v. Wright, 430 U.S. 651, 664-68 (1977)). 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 Amendment’s prohibition of excessive bail may be implicated in civil deportation proceedings. Id. at 263 n.3. In any event, these potentialities were not relevant to the case at hand.
144 Id. at 263-64.
145 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.
146 Id. at 268.
147 Id. at 269. The dissent had an entirely different interpretation of the historical record. See id. at 286-98 (O’Connor, Stevens, J.J., dissenting).
148 Id. at 273 (Blackmun, J.).
149 Id. at 275 (emphasis added).
151 Id. at 604.
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. 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. 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 Circuit affirmed the judgment. Despite the Eighth Circuit Court’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. 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.

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. 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. Likewise, its history supports no such limitation. 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. However, quoting from United States v. Halper, the Court stated that “[t]he notion of punishment, as we commonly understand it, cuts

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152 Id. at 605.
153 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.
154 Id. at 605-06.
155 Id. at 606.
156 Id. at 607.
157 Id. at 608.
158 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 Caredo-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 Caredo-Toledo v. Pearson Yacht Leasing Co., 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 Caredo-Toledo v. Pearson Yacht Leasing Co., 416 U.S. at 682). Only the third type of forfeiture was imported to the United States. Id. at 613 (citations omitted).
159 Id. at 609-10 (quoting Browning-Ferris Ind. of Vermont, Inc. v. Kelco Disposal, Inc., 492 U.S. at 265) (emphasis in original).
across the division between the civil and criminal law.” 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.

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. The Court appeared to equate punishment with retribution and deterrence and examined the history of forfeitures in the United States. 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. Both justifications are, according to Court, rooted in the notion that the property owner has been negligent when his property is misused. 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.

160 *Id.* at 610 ( quoting United States v. *Halper*, 490 U.S. 435, 447-48 ( 1989 )).

161 United States v. *Halper*, 490 U.S. 435, 449 ( 1989 ). In *Halper*, the Court confronted the issue of whether a $2,000 civil penalty for each of 65 false claims violations amounted to a second punishment in violation of the Fifth Amendment. *Id.* at 437-38. 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 prohibited by the Double Jeopardy Clause is determined by a rule of reason.

[W]here 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 ( 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 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 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.

162 *Austin v. United States*, 509 U.S. at 610.

163 *Id.* at 610-18.

164 *Id.* at 615-16.

165 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 ).

166 *Id.* at 618 ( Blackmun, J.).
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.\textsuperscript{167} Consequently, the Court reversed the decision of the Eighth Circuit and remanded the case for further proceedings.\textsuperscript{168} 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.\textsuperscript{169} The forfeiture provisions at issue were clearly designed to buttress criminal sanctions that are, in and of themselves, an inadequate deterrent to engage in an enormously profitable illegal trade.\textsuperscript{170} Moreover, the existence of statutory innocent owner exemptions merely served to more closely establish a nexus between the forfeiture and its punitive objective.\textsuperscript{171}

In \textit{Alexander v. United States}, a companion case to \textit{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 Racketeeer Influenced and Corrupt Organization Act (RICO) that related to the petitioner’s adult entertainment business.\textsuperscript{172} As a result, the petitioner was sentenced to six years in prison, fined $100,000, and ordered to pay costs.\textsuperscript{173} In addition, pursuant to the RICO statute, the petitioner was ordered to forfeit his wholesale and retail businesses and almost $9 million.\textsuperscript{174} The petitioners 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.\textsuperscript{175} 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.\textsuperscript{176}

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.\textsuperscript{177} 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.”\textsuperscript{178} 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

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\textsuperscript{167} id. at 619-622.
\textsuperscript{168} id. at 623.
\textsuperscript{169} id. at 620-21.
\textsuperscript{170} id. at 620.
\textsuperscript{171} id. at 621.
\textsuperscript{172} 509 U.S. 544, 546-47 (1993).
\textsuperscript{173} id. at 548.
\textsuperscript{174} id.
\textsuperscript{175} id. at 548-49.
\textsuperscript{176} The Court rejected the argument that \textit{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. \textit{See} id. at 549-58; 558 n.3.
\textsuperscript{177} id. at 558.
\textsuperscript{178} id.
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constitutionally excessive. For Eighth Amendment purposes, the *in personam* criminal forfeiture under the RICO statute was a fine, defined by the Court as a payment to a sovereign as punishment for some offense.\(^\text{179}\) 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*,\(^\text{180}\) the Court held that the criminal forfeiture of the respondent’s funds as a result of a currency reporting offense violated the Eighth Amendment. 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.\(^\text{181}\) 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.\(^\text{182}\) At trial, the district court found that the respondent’s unreported funds, in their entirety, were subject to forfeiture.\(^\text{183}\) 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.\(^\text{184}\) 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.’”\(^\text{185}\) 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.\(^\text{186}\)

The Ninth Circuit held that a forfeiture must satisfy two conditions in order to pass muster under the Excessive Fines Clause. First, the property forfeited must be an instrumentality of the crime committed. Second, the value of the property forfeited must be proportional to the culpability of the property’s owner. 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. Consequently, the Ninth Circuit had no

\(^{179}\) *Id.*


\(^{181}\) *Id.* at 325 n. 2.

\(^{182}\) *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.*

\(^{183}\) *Id.* at 325-26.

\(^{184}\) *Id.* at 326.

\(^{185}\) *Id.* at 326 ( quoting from the trial transcript ).

\(^{186}\) *Id.*
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.\textsuperscript{187}

The Court, citing \textit{Browning-Ferris Industries}, 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.\textsuperscript{188} The Court rejected the government’s contention that the forfeiture was outside the scope of the Eighth Amendment because it serves remedial purposes. 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.\textsuperscript{189} According to the Court, deterrence is a punitive function and the government’s asserted loss of information is not remedied by the forfeiture.\textsuperscript{190} 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.\textsuperscript{191}

The Court also rejected the government’s contention that the forfeiture in this case bore the indicia of traditional civil \textit{in rem} forfeitures that have not been deemed to be punitive in nature. In \textit{Austin}, the Court placed little stock in the “guilty property” fiction that underpins civil \textit{in rem} forfeitures.\textsuperscript{192} Curiously, the Court did not resort to the reasoning it employed in \textit{Austin} and instead held that the forfeiture provision in this case bore the indicia of a criminal \textit{in personam} forfeiture which have historically been deemed punitive in nature.\textsuperscript{193} The fact that the government did not proceed against the property \textit{in rem} but against the respondent criminally belied the government’s contention that the forfeiture was a typical instrumentality forfeiture.\textsuperscript{194} The Court also noted its agreement with the Ninth Circuit that the currency in this case was not an instrumentality of the offense.\textsuperscript{195} The Court’s decision in this case appears to contradict its holding in \textit{Austin} because it seemingly leaves instrumentality forfeitures immune from Eighth Amendment limitations. In its footnote 8, 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 \textit{ipso facto} punitive and therefore subject to review under the Excessive Fines Clause.”\textsuperscript{196}

\textsuperscript{187} 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. \textit{Id.}

\textsuperscript{188} \textit{Id.} at 327-28 (citing \textit{Browning-Ferris Ind. of Vt., Inc. v. Kelco Disposal, Inc.}, 492 U.S. at 265). In \textit{Austin}, the Court nodded approvingly to \textit{Halper} and its holding that civil penalties could indeed trigger the application of the Double Jeopardy Clause of the Fifth Amendment. \textit{See supra} note 161 at accompanying text. \textit{Halper}’s holding was effectively overturned in \textit{Hudson} v. United States, 522 U.S. 93 (1997). \textit{See id.}. \textit{Bajakajian} was decided one year after \textit{Hudson} and the Court made no mention of \textit{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.

\textsuperscript{189} \textit{United States v. Bajakajian}, 524 U.S. at 329.

\textsuperscript{190} \textit{Id.}

\textsuperscript{191} \textit{Id.} at 329 n.4.

\textsuperscript{192} \textit{See supra} notes 164-66 and accompanying text.

\textsuperscript{193} \textit{United States v. Bajakajian}, 524 U.S. at 331-33.

\textsuperscript{194} \textit{Id.} at 333.

\textsuperscript{195} \textit{Id.} at 334 n.9.

\textsuperscript{196} \textit{Id.} at 333 n.8 (emphasis in original).
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 relation to the gravity of the offense that it is designed to punish.” 197 The Court found no support in the text if the Constitution and little guidance in the historical record for the application of the proportionality standard. 198 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.” 199 Moreover, judicial determinations concerning the gravity of an offence are inherently imprecise. 200 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. 201 As a result, a fine is excessive only if it is grossly disproportionate to the gravity of the offense for which it is imposed. 202

The Court held, for several reasons, that the forfeiture of approximately $357,000 in this case would violate the Excessive Fines Clause. 203 First, the crime for which the forfeiture was sought was solely a reporting violation. 204 The possession and transport of currency were permissible activities. Second, the reporting violation in this case was unrelated to any other illegal activities. The respondent did not fall within the class of persons - money launderers, drug traffickers, and tax evaders - for whom the reporting obligation was designed. 205 Third, the maximum penalties provided under the Sentencing Guidelines confirmed the respondent’s minimal level of culpability. 206 Fourth, the harm caused by the respondent’s offense was minimal. 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. 207 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. 208

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

197 Id. at 334.
198 Id. at 335-36.
199 Id. at 336 ( citing to Solem v. Helm, 463 U.S. 277, 290 ( 1983 )).
200 Id.
201 Id.
202 Id. at 337.
203 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. at 338 n.11.
204 Id. at 337.
205 Id. at 338.
206 Id. at 338-39.
207 Id. at 339.
208 Id.
government’s interest in customs revenue.\textsuperscript{209} 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.\textsuperscript{210} The Court again appeared to place emphasis on the fact that such penalties were enforced in civil \textit{in rem} procedures.\textsuperscript{211}

### 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.\textsuperscript{212} Otherwise, the maximum criminal sanctions are halved.\textsuperscript{213} 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.\textsuperscript{214} 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 fifty percent of the account balance for each reporting violation. 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. The maximum FBAR penalties, in addition to other penalties, amounted to \$29,876,593.

The threshold issue is whether the FBAR civil penalty is amenable to Eighth Amendment scrutiny. As the Court made clear in \textit{Austin}, the classification of an exaction as civil or criminal is not determinative.\textsuperscript{215} Instead, the Excessive Fines Clause is a limitation on any exaction imposed by the sovereign that is punitive in nature.\textsuperscript{216} Moreover, because the FBAR penalty is not an \textit{in rem} forfeiture, the Court’s apparent resuscitation of the \textit{in rem} / \textit{in personam} distinction in \textit{Bajakajian} is not relevant.\textsuperscript{217} The statute does not impose a forfeiture of the funds contained in

\textsuperscript{209} \textit{Id.} at 340-43.
\textsuperscript{210} \textit{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. \textit{See} United States v. Fogg, 666 F.3d 13, 19-20 (1\textsuperscript{st} Cir. 2011).
\textsuperscript{211} United States v. Bajakajian, 524 U.S. at 343 n. 18.
\textsuperscript{212} \textit{See supra} note 39.
\textsuperscript{213} \textit{Id.}
\textsuperscript{214} \textit{See supra} notes 37-94 and accompanying text.
\textsuperscript{215} \textit{See supra} notes 157-60 and accompanying text.
\textsuperscript{216} \textit{See supra} note 159 and accompanying text.
\textsuperscript{217} \textit{See supra} notes 193-96 and accompanying text.
undisclosed accounts but rather a monetary fine based on the balances of such accounts. Moreover, 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. 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 United States 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. Any remedial purpose served by the penalty regime does not vitiate its deterrent aspect as a trigger for Eighth Amendment scrutiny.

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. 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.

B. Gross Disproportionality Test

Despite the relatively pedestrian determination that the FBAR penalties are subject to the 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 report 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. The maximum criminal fine for failure to report foreign financial accounts is $500,000, ten years imprisonment,

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218 See supra note 38 and accompanying text.
219 See supra notes 194-95 and accompanying text.
220 See supra notes 163,190 and accompanying text.
221 See supra notes 166,191 and accompanying text.
222 See supra note 83 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 191 and accompanying text.
223 See supra notes 68-94 and accompanying text.
or both. 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 non-forfeiture 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 that 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.\footnote{See infra notes 276-77 and accompanying text.} 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.\footnote{See supra note 6 and accompanying text.} 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.\footnote{See supra notes 24-33 and accompanying text.} 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 purpose broader than tax collection.\footnote{See supra note 82 and accompanying text.} 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 is 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 I.R.S. 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

\footnotesize{224 See infra notes 276-77 and accompanying text.}
\footnotesize{225 See supra note 6 and accompanying text.}
\footnotesize{226 See supra notes 24-33 and accompanying text.}
\footnotesize{227 See supra note 82 and accompanying text.}
nothing more than 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.228 Congress has spoken directly to the seriousness of tax evasion 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.229 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.230

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.231 On the other hand, the fact that the penalties imposed under the OVDP are significantly less than the statutory

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228 See e.g., United States v. $134,750 U.S. Currency, 2013 U.S. App. LEXIS 15015 (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 **22. 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, 600 F.3d 270 (3d Cir. 2010), the court held that the forfeiture of approximately $500,000 of firearms and ammunition was constitutional. The respondent pled 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. at 284-85. See also United States v. Blackman, 2014 U.S. App. LEXIS 5323, *18-19 (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).

229 See supra notes 125-31 and accompanying text.

230 See supra notes 109-14 and accompanying text.

231 The Court in Bajakajian rejected the notion that repeated falsehoods increase culpability. United States v. Bajakajian, 524 U.S. at 337 n. 12.
penalties supports the notion that the harm caused by the tax evasion is dramatically overstated by such statutory penalties.\textsuperscript{232}

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 I.R.S. and the statutory barriers to pre-enforcement judicial challenges of tax matters.\textsuperscript{233} The I.R.S.’s laxity in complying with the Administrative Procedure Act is well known. Except for military, foreign affairs, and certain managerial, personnel, and other matters not relevant here, the Administrative Procedure Act requires that notice and comment procedures be adhered to in the promulgation of proposed regulations.\textsuperscript{234} The notice and comments requirements do not apply to interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice.\textsuperscript{235} 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 Internal Revenue Code section 7805(a) which delegates general regulatory authority to the Treasury for the enforcement of the Internal Revenue Code.\textsuperscript{236} 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 Administrative Procedure Act.\textsuperscript{237} Moreover, it has become

\textsuperscript{232} See supra note 133 and accompanying text.

\textsuperscript{233} 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) (2010). In addition, the statutory lien provisions for unpaid taxes are very broad and bypass state law secured lending and real property law. See generally I.R.C. §§ 6321-6327 (CCH 2014). The I.R.S. is also granted broad levy powers. See generally I.R.C. §§ 6331-6344 (CCH 2014).

\textsuperscript{234} 5 U.S.C. §§ 553(a)-(b) (2010).

\textsuperscript{235} 5 U.S.C. § 553(b)(2010). 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.

\textsuperscript{236} I.R.C. § 7805(a) (CCH 2014). Under the Internal Revenue Code, regulatory authority is delegated to Secretary of the Treasury. The I.R.S., however, has a significant role in the drafting of regulations. See Kristin E. Hickman, A Problem of Remedy: Responding to Treasury’s (Lack of) Compliance with the Administrative Procedure Act Rulemaking Requirements, 76 Geo. Wash. L. Rev. 1153, n.3 (2008). 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(1) (CCH 2014).

\textsuperscript{237} See Hickman, supra note 236, 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 n.16. This distinction has been criticized by several commentators and discounted by the courts. See e.g., Mayo Found. for Med. Educ. and 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.
a common practice of the Treasury to issue binding temporary regulations contemporaneously with a Notice of Proposed Rulemaking. Thus, the temporary regulations are binding upon taxpayers without any opportunity for pre-promulgation comment.

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.* has been expanded with respect to review of actions taken by the I.R.S. 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. 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. 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

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Natural Res. Def. Council, 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 the Administrative Procedure Act Rulemaking Requirements*, 82 NOTRE DAME L. REV. 1727, 1760-73 (2007). See also *ABA Section of Taxation Report of the Task Force on Judicial Deference*, 57 TAX LAW. 717 (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)(2010).

See Hickman, *supra* note 236, at 1160. Temporary regulations must also be issued as proposed regulations and expire within three years of issuance. I.R.C. § 7805(e)(CCH 2014). More problematic is the I.R.S.’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, 814-15. See also Internal Revenue Service, *Understanding IRS Guidance - A Brief Primer, available at* http://www.irs.gov/irs/article/0,,id=101102,00.html. Each weekly Internal Revenue Bulletin, in which the rulings are published, explicitly states that these rulings do not have the force and effect of regulations but that they may be used as precedent by taxpayers. I.R.S. 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.


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 v. United States, 440 U.S. 472, 477 (1979).
under the general statutory grant of authority under Internal Revenue Code section 7805.\textsuperscript{243} However, in 2011 the Court, in \textit{Mayo Foundation for Medical Education and Research v. United States} held that the \textit{Chevron} standard applied to all Treasury regulations issued after notice and comment.\textsuperscript{244} Accordingly, like any other agency regulations, tax regulations, regardless of their source of authority, are entitled to \textit{Chevron} deference.\textsuperscript{245}

Judicial review of final agency actions is presumed under the Administrative Procedure Act.\textsuperscript{246} However, judicial review of tax actions is circumscribed by I.R.C. section 7421, the Anti-Injunction Act. This statute prohibits, subject to 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.”\textsuperscript{247} 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.”\textsuperscript{248} The Tax Injunction Act also precludes

\textsuperscript{244} Mayo Found. for Med. Educ. and Research v. United States, 131 S.Ct. 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 the I.R.S. over taxpayers. See \textit{ABA Section of Taxation Report of the Task Force on Judicial Deference}, supra note 237, at 723-24.
\textsuperscript{245} Mayo Found. for Med. Educ. and Research v. United States, 131 S.Ct. at 713. Informal agency guidance, however, is not entitled to \textit{Chevron} deference. In \textit{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 \textit{Skidmore} standard – survived \textit{Chevron}. United States v. Mead, 533 U.S. at 225. Under \textit{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 \textit{Skidmore v. Swift & Co.}, 323 U.S. 134, 140 (1944).
\textsuperscript{247} I.R.C. § 7421(a) ( CCH 2014 ). 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 I.R.S. See I.R.C. § 7426(b) ( CCH 2014 ). Moreover, third parties are expressly provided standing to vindicate an interest in property that has been wrongfully levied. I.R.C. § 7426(a) ( CCH 2014 ). 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 I.R.C. §§ 6015(e)(1)(B)(2); 6330(e)( CCH 2014 ).
\textsuperscript{248} Hibbs v. Winn, 542 U.S. 88, 103 (2004). 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. \textit{Id.} at 102-12. See also \textit{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. \textit{See id.} at 1284-85. 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 \textit{Enoch v. Williams Packing &
lower federal court interference with the assessment, levy or collection of any tax under state law.\textsuperscript{249} In addition, the Declaratory Judgment Act precludes any declaratory judgments “with respect to Federal taxes.”\textsuperscript{250}

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 non-compliance and the reputational harm attendant to non-compliance.\textsuperscript{251} Reputational harm is, in turn, dependent upon cultural norms and transparency.\textsuperscript{252} Deterrence can, over time, heighten the reputational harm incident to non-compliance by nudging cultural norms toward compliance.\textsuperscript{253} Conversely, the potential for significant reputational damage is a further deterrent to non-compliance because it increases the cost of such non-compliance if it is discovered.\textsuperscript{254}

The size of the sanctions for non-compliance 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.\textsuperscript{255} 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 non-compliance.\textsuperscript{256} Alternatively, if the detection rate is five percent then the sanction must be set

\begin{itemize}
\item \textsuperscript{249} 28 U.S.C. § 1341 (2010).
\item \textsuperscript{250} 28 U.S.C. § 2201(a)(2010). 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 (CCH 2014).
\item \textsuperscript{251} 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).
\item \textsuperscript{252} See id. at 685-86, 692.
\item \textsuperscript{253} Id. at 685-86.
\item \textsuperscript{254} Id.
\item \textsuperscript{255} 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., 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 Benthem); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 194, 203 (3d ed. 1986)
\item \textsuperscript{256} 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
\end{itemize}
sufficiently high so as to overcome the low probability of detection. Criminal sanctions, particularly the possibility of imprisonment, serve this function.\textsuperscript{257}

Levels of voluntary compliance are high in the United States.\textsuperscript{258} For the most part, the third-party reporting requirements with respect to wages, interest, dividends, and many other forms of income ensures an extremely high detection rate for noncompliance.\textsuperscript{259} 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.\textsuperscript{260} 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 noncompliance. Whether or not the United States enjoys the benefits of such a norm is beyond the scope of this work.\textsuperscript{261} Anecdotally, however, it is arguable that the high levels of voluntary from non-compliance if she earns 15 percent on the funds that should have been paid to the government.\textsuperscript{257} Of course, most, if not all, taxpayers are aware of the \textit{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. \textit{See e.g.}, Jesse Eisinger, Seeking Tough Justice, but Settling for Empty Promises, \textit{N.Y. Times}, May 8, 2014, at B5 ( criticizing the Justice Department’s efforts in prosecuting executives ); Ben Protess, \textit{Key U.S. Prosecutor is Latest to Join Law Firm}, \textit{N.Y. Times}, April 29, 2014, at B9 ( reporting that another senior Justice Department 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 ).\textsuperscript{258} \textit{See} \textit{Morse}, \textit{supra} note 251, at 679 ( citing a 2006 Dep’t. of the Treasury report ). \textit{See also} I.R.S. News Release IR-2014-2 ( Jan. 6, 2012 ) ( estimating a compliance rate in 2006 of approximately 83 percent, a rate that was virtually unchanged from the compliance rate estimated in 2001 ).\textsuperscript{259} \textit{See e.g.}, I.R.C. §§ 6041 ( requiring persons engaged in a trade or business to report payments of wages, salaries, rents, and certain other items ); 6042 ( requiring the reporting of dividend payments ); 6045 ( requiring brokers to report gross proceeds derived by customers ); 6049 ( requiring the reporting of interest payments ) ( CCH 2014 ). The I.R.S. estimated that the rate of underreporting of wage and salary income in 2006 was one percent. \textit{See} I.R.S. News Release 2012-4, \textit{supra} note 258.\textsuperscript{260} The audit rate for the fiscal year ended Sept. 30, 2013 was approximately 1 percent. \textit{See} \textit{INTERNAL REVENUE SERV.}, \textit{PUB. 55B, DATA BOOK}, 2013, at 22 table 9a ( March 2014 ), \textit{available at} \url{http://www.irs.gov/pub/irs-soi/13databk.pdf}. The I.R.S. does seek to identify higher risk taxpayers for audits through the use of statistical methods. \textit{See generally} William Hoffman, \textit{IRS Doesn’t Target Small Businesses for Audits, Werfel Says}, 140 TAX NOTES 304 ( July 22, 2013 ).\textsuperscript{261} A recent cross-country study found that attitudes toward tax compliance in the United States are influenced by taxpayers’ education levels, gender, and age. \textit{See} Robert W. McGee & Adriana
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.\textsuperscript{262} 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.\textsuperscript{263} Moreover, the existence of a 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.\textsuperscript{264} To be sure, the possibility of

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\begin{footnotesize}262\end{footnotesize} Such taxpayers have non-compliance rates of approximately 50 percent. \textit{See} Susan Cleary Morse, Stewart Karlinsky & Joseph Bankman, \textit{Cash Businesses and Tax Evasion}, 20 STAN. L. & POL’Y REV. 37, 39 (2009). The I.R.S. 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. \textit{See} I.R.S. News Release 2012-4, \textit{supra} note 258.


\begin{footnotesize}264\end{footnotesize} Tax returns and tax return information were made confidential in the aftermath of the Watergate scandal and the Nixon Administration’s enlistment of the I.R.S. to further its political goals. \textit{See} I.R.C. § 6103(a) (CCH 2014). \textit{See also supra} note 95. 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); 6103(f); 6103(j); 6103(g)(1)-(2) (CCH 2014). Willful unauthorized disclosures are punishable by fines, incarceration, and dismissal from office. I.R.C. § 7213(a) (CCH 2014). Civil actions may also be brought against the United States for knowing or negligent unauthorized disclosures. I.R.C. § 7431(a)(1) (CCH 2014). Moreover, anti-browsing provisions were in enacted in response to evidence that I.R.S. employees were browsing taxpayer records for no legitimate purpose. I.R.C. § 7213A(a) (CCH 2014). 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. \textit{See, e.g.}, MODEL RULES OF PROF’L CONDUCT R. 1.6 (2003); MODEL CODE OF PROF’L RESPONSIBILITY DR 4-101 (1980). Privilege has been extended to accountants and other practitioners before the I.R.S. I.R.C. § 7525 (CCH 2014).

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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 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. 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. Disparities between the growth of income and the growth of wealth for wealthy U.S. taxpayers indicate that a significant portion of wealth is hidden offshore. The United States expends significant resources and diplomatic capital in arm-twisting the financial services industry and foreign governments to provide her with assistance in combatting tax evasion. FATCA is the latest attempt by the United States to enlist third-parties to provide her with assistance in the enforcement of her tax laws. FATCA includes significant deterrence to noncompliance by foreign financial institutions. 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. The Court, however, had to decide whether a particular person in particular


266 See James S. Henry, The Price of Offshore Revisited, Tax Justice Network (July 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 251, 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. 14415, 14416 n.5 (March 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.


268 See supra notes 9-15 and accompanying text.

269 See supra notes 95-114 and accompanying text.

270 See supra note 97 and accompanying text.

271 See supra note 181 and accompanying text.
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. I believe that 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. The civil tax penalties for this evasion amount to $1,348,013. 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. These totals do not include interest payable on the underpayments. The FBAR penalties amount to $29,876,593. Because the FBAR penalties are based on the balances in the unreported foreign financial accounts these penalties may only bear a loose relationship to the amount of tax that is unreported. The example above assumed a six 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. 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 a net operating loss carryovers or foreign tax credits. 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. Moreover, Congress recently targeted the reporting offense itself through the enactment of the FATCA.

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272 See supra note 127 and accompanying text.
273 This figure represents the sum of the cumulative understatement penalties and the cumulative fraud penalties. See supra notes 128-29 and accompanying text.
274 See supra notes 120-23 and accompanying text.
275 See supra note 131 and accompanying text.
276 In the above example, the FBAR penalties would be reduced if the account in question earned a reduced rate a 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.
277 See e.g., I.R.C. §§ 172; 901 ( CCH 2014 ). 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 in 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.
278 The substantial understatement penalty has been doubled, from 20 percent to 40 percent, for underpayments related to unreported foreign income. See supra note 128 and accompanying text.
penalty—a modest $10,000 penalty at that. 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.

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 her failure 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. 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. 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. 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 “fables” that respondent told one month, or six months, later.

279 See supra note 98 and accompanying text.
280 Both FATCA and the heightened understatement penalty were enacted in 2010. See supra notes 98, 128 and accompanying text.
281 See supra note 83 and accompanying text.
282 The various levels of mitigation are based on the size of the account balances in question. See supra notes 56-60 and accompanying text.
283 See supra note 133 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 77.
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. Other forms of tax evasion have been singled out for harsh treatment – tax shelters and overvaluations of property, for example. 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 that 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. 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.

IV. CONCLUSION

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 principle 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.

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)(CCH 2014). Moreover, certain tax shelter transactions must be reported and significant penalties may be imposed on tax shelter promoters. See I.R.C. §§ 6707A; 6700 (CCH 2014). 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 I.R.C. § 6662(h) (CCH 2014).

See supra note 272-73 and accompanying text.
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 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.