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Top US Int'l Tax Cases Of 2021: Midyear Report

By **David Hansen**

Law360 (July 2, 2021, 6:24 PM EDT) -- Federal courts handed down a number of significant international tax decisions in the first half of 2021, including multiple rulings concerning foreign bank account reporting failures, where judges generally went easy on inadvertent nonfilers while upholding harsh penalties for willful violations.

Meanwhile, in what critics see as an infringement on a fundamental right, courts have rejected challenges to the government's policy of denying passports to those with significant tax debts. According to these rulings**,** the right to travel, while it may be ancient, is not embedded in the U.S. Constitution.

In other developments, an expatriate attorney may be running out of time to contest new transition tax regulations, and Exxon Mobil escaped a $207 million penalty in a case that showed a potential risk of filing an amended tax return.

Here, Law360 presents the top international tax cases in U.S. courts from the first half of 2021.

Courts Show Leniency for Nonwillful FBAR Violations

Several federal courts limited the penalties that the government can levy against taxpayers who inadvertently fail to report their foreign bank accounts. Courts over the last six months have curtailed penalties in nonwillful cases even as a growing pattern of case law gives the federal government more authority to prove willfulness in FBAR matters.

Under the Bank Secrecy Act, U.S. citizens and legal residents with $10,000 or more held abroad must file foreign bank account reports, or FBARs, with the U.S. Treasury Department's Financial Crimes Enforcement Network.

Several federal judges, including District of Connecticut Judge Kari A. Dooley, **ruled that the maximum penalty** for unintentionally failing to file a report is $10,000 per year, not $10,000 per unreported account. The issue was a matter of first impression in the Second Circuit and much of the country, Judge Dooley noted in a case involving taxpayer Zvi Kaufman.

In the case before Judge Dooley, Kaufman failed to report multiple accounts in Israeli banks for years 2008 through 2010, and the Internal Revenue Service assessed $186,679 in penalties, interest and late fees.

Judge Dooley found that the maximum penalty the IRS could impose was $10,000 for each yearly report and not for each foreign account. When Congress set the penalty for nonwillful mistakes, it did not link it to every account, the judge said. She also held that the penalty for willful violations is determined by how much money is in an account.

Kaufman attorney Jeffrey Neiman told Law360 that courts are siding with taxpayers on this issue as a reaction to heavy-handed enforcement by the IRS.

"The IRS defies common sense," Neiman said. "I don't know why they are going after people who by their own admission made a mistake."

A representative of the IRS declined to comment.

The case is U.S. v. Zvi Kaufman, case number 3:18-cv-00787, in the U.S. District Court for the District of Connecticut.

A New Jersey federal court **made a similar finding** in March, reducing taxpayer Frank Giraldi's penalty from $160,000 to $40,000 — a fine for each year he unintentionally didn't file rather than for each account. Congress set the penalty for intentional failure at a per-account basis, but did not do so for unintentional errors, the court determined. Applying a per-account penalty could punish taxpayers who inadvertently failed to file more harshly than those who deliberately did so, it added.

The case is U.S. v. Frank Giraldi, case number 2:20-cv-02830, in the U.S. District Court for the District of New Jersey.

Appeals courts have ruled the same way over the last six months. A divided Ninth Circuit in March **reversed a California federal court** by limiting a penalty for a nonwillful violation to $10,000 a year in the case of Jane Boyd, who failed to report 14 foreign bank accounts during 2010. The IRS had accepted that she did so unintentionally but still penalized her per account.

Judge Mark J. Bennett, writing for the majority, held that because Boyd had failed to file a single FBAR listing the accounts, she was liable for just a single violation.

Dissenting Judge Sandra S. Ikuta, meanwhile, said the majority incorrectly focused on the form taxpayers must report rather than the details in it. The majority's decision will hamper the IRS' efforts to curtail tax abuse, she warned.

The case is U.S. v. Jane Boyd, case number 19-55585, in the U.S. Court of Appeals for the Ninth Circuit.

While courts showed leniency for nonwillful violations during the first half of 2021, they also upheld harsher penalties for willful violations.

In U.S. v. Rosales, a Texas federal court **allowed the IRS to penalize** a taxpayer $3.3 million for intentionally failing to file FBARs from 2005 to 2012, or an average of $412,000 a year. And in U.S. v. Goldsmith, the government **penalized a taxpayer** almost $300,000 for failing to file FBARs between 2008 and 2010. A California federal court refused to accept Goldsmith's excuse that he failed to review his tax returns, determining that such reckless conduct constituted willfulness.

Practitioners should always expect the government to aggressively pursue penalties regardless of the type of FBAR case they defend, Horwitz & Citro partner Vincent Citro told Law360.

"Will the IRS ever not want more money?" he said. "The IRS will continue pushing for higher penalties if there is any justification."

Judges OK Passport Denials for Overdue Taxes

In what some practitioners have criticized as a violation of due process, two courts in the last six months have held that the government can deny passports to taxpayers with significant tax debts. International travel is not a constitutional right, the courts held, over strenuous objections from taxpayers.

One of those taxpayers, Craig Thomas Jones, traced the right to travel abroad back to Magna Carta, which under English law gave people an inalienable right to leave and return to the kingdom.

Jones told Law360 that the right was so common that the framers of the Constitution may have taken it for granted and left it out. It also is implicit in the Ninth Amendment, he argued, which is the source of other personal rights such as marriage and divorce.

"There needs to be more due process, a showing that the person is hiding assets or evading taxes," Jones said. "But to simply say you are delinquent in your taxes — if they can deny me a passport for that, who says they can't take away the right to vote or have a gun or get a marriage license?"

The Fixing America's Surface Transportation Act of 2015 empowers the U.S. State Department to deny passports to taxpayers with $50,000 or more of tax debt, indexed to inflation. Internal Revenue Code Section 7345 directs the Treasury Department to notify the State Department of taxpayers whose debts qualify.

A Georgia federal judge **rejected Jones' arguments** in March, and the taxpayer later dropped his Eleventh Circuit appeal. He had hoped to argue the case before the U.S. Supreme Court, but it became moot once he paid his debt, he told Law360.

A U.S. Tax Court ruling in March **rejected a California taxpayer's arguments** that Section 7345 violated the Fifth Amendment by prohibiting international travel. Judge Emin Toro stated that Section 7345 merely stipulates the process for the IRS to transmit tax debt information to the State Department, which makes the final call.

The taxpayer's co-counsel, Nicholas Rosado, told Law360 that past judicial rulings have only allowed the government to limit the right to international travel when there are concerns it threatens national security or is for criminal purposes. He said courts are now expanding the government's power to impose travel bans on mere debtors, requiring only a rational purpose to pass constitutional muster.

The cases are Craig Jones v. Steven Mnuchin et al., case number 1:19-cv-00222, in the U.S. District Court for the Southern District of Georgia, and Robert Rowen v. Commissioner, docket number 18083-18P, in the U.S. Tax Court.

Expat Stumbles in Challenge to Transition Tax Rules

An expatriate attorney may be running out of time for any meaningful challenge to the government's implementation of transition tax reforms in the 2017 Tax Cuts and Jobs Act , as most taxpayers have already paid whatever they owe under the new regulations.

The attorney, Monte Silver, had argued the IRS violated the Regulatory Flexibility Act by failing to analyze the rules' impact on small businesses before finalizing them. Silver also objected to the "impenetrable" provisions and the many "unreasonably complicated burdens" they impose on small companies.

A D.C. federal court **found Silver failed to show** how issuing the analysis would redress a past injury, as he had already paid for the cost of complying and owed no tax under the new regulations. Nor could he prove that he would be harmed in the future by the lack of an analysis, the court said. He alleged future compliance might cost him money, but showed no proof he suffered from imminent injury, the court said.

Silver is appealing the decision, but time is on the government's side, according to Miller & Chevalier Chtd. member Steven Dixon.

"The further we get from the effective period of the transition tax regulations, the less important this claim will appear to the court," Dixon told Law360. "The transition tax is a dead letter — either you paid or not — and as a general rule, it is something in the past."

The case is Monte Silver and Monte Silver Ltd. v. the Internal Revenue Service et al., case number 1:19-cv-00247, in the U.S. District Court for the District of Columbia.

$207M Exxon Case Serves as Cautionary Tale

A $207 million penalty that Exxon Mobil Corp. escaped in January should be a warning for taxpayers that the IRS will scrutinize amended returns filed to take advantage of tax shelters, a leading practitioner told Law360.

Exxon had filed an amended tax return seeking a $1.35 billion refund based on recharacterizing oil and gas production from Qatar and Malaysia as a sale, not a mineral lease. The IRS not only denied the refund but hit Exxon with $207 million in penalties, accusing it of filing an excessive refund request under Internal Revenue Code Section 6676 .

Section 6676 allows the IRS to slap a 20% penalty on excessive refund requests unless the taxpayer had a reasonable basis for the refund. Exxon did not, the IRS said. The amended return also changed the accounting rules Exxon used to determine its income, the IRS said. A change requires preapproval by the agency, which Exxon did not obtain, the IRS said.

Exxon argued that it had a reasonable basis for claiming the refund. It also said the recharacterization did not change the accounting methods it used. Accounting methods determine when an item is included in income, not whether it is included, the company said.

A Texas federal judge agreed. Exxon had **based its arguments** on Treasury regulations, a solid authority, the court said. It also had legal support that a change that affects whether, not when, an item is charged as income is not an impermissible change in accounting method, the court said.

The IRS is increasingly using Section 6676 to penalize taxpayers filing amended returns, Gray Reed & McGraw LLP partner David Gair told Law360. Practitioners should thus always be prepared for an audit when amending, he said.

"It is an area that is causing a lot of problems for tax practitioners and taxpayers in general," he said. "Make sure whatever you file is 100% true and complete, because if you can't and the IRS audits you, the 6676 penalty is coming your way."

The case is Exxon Mobil Corp. v. U.S., case number 3:16-cv-02921, in the U.S. District Court for the Northern District of Texas.

--Editing by Aaron Pelc and Vincent Sherry.
