Taxpayers' FBAR Fifth Amendment Gambit Fails

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A district court has found that a couple acted willfully when they failed to report their accounts on a foreign bank account report, despite their invocation of their Fifth Amendment privilege against self-incrimination on the FBAR.

The U.S. District Court for the Eastern District of New York granted the government partial summary judgment September 14 in *United States v. Bernstein*, while denying Daniel and Yana Bernstein their similar motion. The court held that it did not need to reach the issue of privilege in ruling against them because their reasoning for not providing the FBAR information was "immaterial."

"The other evidence of willfulness, particularly the history of these accounts leading up to their action in 2010, is so one-sided that no reasonable jury could find otherwise," Judge Brian M. Cogan wrote. "The subject accounts were born of and raised on a deliberate desire to evade tax reporting. The Bernsteins' decision in 2010 to finally file an FBAR had the additional purpose of avoiding criminal prosecution, but that did not excise their continuing goal of avoiding their reporting obligation."

The Justice Department has sought more than $500,000 in FBAR penalties and interest against the Bernsteins for willful violations of reporting obligations from the 2010 tax year. The Bernsteins held multiple accounts in UBS from 2002 to 2009 until liquidating their interests there and transferring them to another Swiss entity, Bank Sal. Oppenheim Jr. & Cie. (Switzerland) Ltd., after the Justice Department announced a deferred prosecution

agreement with UBS.

From 2002 to 2009, the Bernsteins' returns indicated they did not have financial interests in foreign accounts. For their 2010 return, however, the Bernsteins did not answer line 7a of Schedule B regarding whether they had a financial interest in or signature authority over a foreign account. Instead, on advice of their counsel Lawrence Feld, they stated in an addendum that they had decided to "invoke their rights under the Fifth Amendment of the United States Constitution not to incriminate themselves." The Bernsteins filed their FBAR, providing their names, addresses, and Social Security numbers and invoking their Fifth Amendment privilege on a question-by-question basis.

'A Clear Choice'

The Bernsteins relied on *Cheek v. United States*, 498 U.S. 192 (1991), a case involving a tax evasion prosecution for nonfiling of returns in which the Supreme Court held that willfulness was a subjective standard, which requires a knowing, voluntary, and intentional violation of the law. But the court found more persuasive the decisions in both *Bedrosian v. United States*, 912 F.3d 144 (3d Cir. 2018), which it said "has a lot of similarities to the instant case," and *Lefcourt v. United States*, 125 F.3d 79 (2d Cir. 1997).

In *Bedrosian*, the Third Circuit held that the government must satisfy the civil willfulness standard, which includes knowing and reckless behavior, in proving a willful FBAR violation. In *Lefcourt*, the Second Circuit affirmed a district court decision that upheld a section 6721 penalty assessed against a law firm that, on the basis of the attorney-client privilege, refused to report on Form 8300 the name of a client from which it had received more than $10,000 in cash.

According to the court, the Bernsteins' use of tax haven offshore accounts was "not exactly something undertaken by the unsophisticated taxpayer." The court noted how the Bernsteins placed funds at UBS for nearly a decade, avoided telling their accountant about them to avoid disclosure, falsely answered Schedule B for seven years, moved their

accounts to a private bank after learning about the deferred prosecution agreement, declined to participate in the voluntary disclosure program, and made a limited disclosure in 2010.

"The Bernsteins had a clear choice: disclose the required information and risk a criminal prosecution for earlier years, or abstain from disclosing with a good-faith assertion of their privilege and hope that would eliminate criminal liability and hopefully, perhaps as a matter of negotiation, limit civil liability," the court wrote. "They made a good choice; they appear to have avoided criminal liability despite what is almost certainly criminal conduct in prior years. But it was most definitely a voluntary, deliberate, and willful choice."

Cogan also held that if the case were to go to jury, he might have provided jury instructions allowing the jury to draw an adverse influence because of the use of the privilege. The court found a distinction between using the privilege "as a shield against criminal liability as opposed to a sword to cut off civil liability," comparing the latter to a tax planning instrument.

"It would be all too easy for tax cheats, once caught or on the verge of getting caught, to invoke their Fifth Amendment and avoid civil tax penalties. That result would be unacceptable and there is no precedent for it," Cogan wrote.

Reading Between the Lines

Jeffrey Neiman of Marcus, Neiman, Rashbaum & Pineiro LLP said advisers should read between the lines of the decision.

"Lawyers can continue to advise clients in appropriate circumstances that it would be wise to assert your Fifth Amendment privilege in order to protect yourself in the face of a criminal investigation, but according to at least this judge, there is going to be a price that comes with it. And that price is the willful FBAR penalty," Neiman said.

Neiman added that the opinion does not appear to address what impact a lawyer's advice

would have on determining willfulness.

"This almost seems like if you assert a Fifth Amendment privilege on your FBAR, we're dealing with a strict liability willful penalty. That seems to run afoul [of] . . . the concept of having willful versus non-willful penalties," Neiman said.

Practitioners have previously expressed concern over any suggestion that taxpayers may not be able to use good-faith reliance on an adviser as a defense in cases involving willful FBAR penalties.

According to Josh O. Ungerman of Meadows, Collier, Reed, Cousins, Crouch & Ungerman LLP, the court went to lengths to limit the application of *Cheek*.

"The court also limits the ability of the taxpayers to overcome the willfulness requirement for the civil FBAR penalty by relying on the advice of experienced tax controversy counsel as to the understanding that filing an FBAR with a Fifth Amendment reservation constitutes full compliance with the filing requirement. The court unrealistically posits that the taxpayers for the 2010 FBAR could have made a 'full disclosure' and retained the ability to negotiate both civilly and criminally," Ungerman said. "This case is an example of the old adage, bad facts make bad law."

In *United States v. Bernstein*, No. 1:19-cv-02912, the Bernsteins are represented by Zhanna A. Ziering and Scott D. Michel of Caplin & Drysdale Chtd.

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