CHANGING THE BURDEN OF PROOF IN WILLFUL FBAR VIOLATION CASES?

TRISHA A. WALD*

I. GENERAL

A. *The Offshore Tax "Loophole"*

In recent years, the Internal Revenue Service (the "Service") has become increasingly convinced that it is losing out on billions of dollars in tax revenue due to U.S. citizens "hiding" money in bank accounts in other countries with more favorable tax regimes. Historically, those other countries with favorable tax rules which have "encouraged" U.S. investments in their country have included Switzerland, the Bahamas, and the Cayman Islands. These foreign banks, unlike U.S. banks, are not required to provide information to the Service on depositors and interest earned; as such, the Service fears that many taxpayers are deliberately not claiming income received in these countries on their individual tax returns. Since 2007, the Service and Congress have stepped up their efforts to find and penalize these taxpayers.

Generally speaking, a taxpayer with a foreign account(s), must do three (3) things to not run afoul of the government and its regulations. First, a taxpayer must claim income earned on any foreign accounts.[1] Second, a taxpayer must check the "Yes" box on Schedule B of his or her Form 1040 to acknowledge said accounts.[2] Third, if required, based on monetary amounts, the taxpayer must file an FBAR with the Treasury Department by June 30.[3] Finally, a taxpayer may have to file Form 8938,[4] which is not to be confused with the FBAR.

B. *Requirement 1: Taxation of Worldwide Income*

Under § 61(a) of the Internal Revenue Code of 1986, as amended ("Code"), "gross income means all income from whatever source derived,

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* J.D., Associate Professor, Southwestern Oklahoma State University.

[1] *See infra* Section 1B.

[2] *See infra* Section 1C.

[3] *See infra* Section 1D.

[4] *See infra* Section 1E.

including (but not limited to) the following items: (1) Compensation for services, including fees, commissions, fringe benefits, and similar items; (2) Gross income derived from business; (3) Gains derived from dealings in property; (4) Interest; (5) Rents; (6) Royalties; (7) Dividends; (8) Alimony and separate maintenance payments; (9) Annuities; (10) Income from life insurance and endowment contracts; (11) Pensions; (12) Income from discharge of indebtedness; (13) Distributive share of partnership gross income; (14) Income in respect of a decedent; and (15) Income from an interest in an estate or trust.[5]

Under this broad definition of gross income, a U.S. citizen, resident alien or domestic corporation is taxed on its worldwide income – including income earned or received domestically, as well as income earned or received internationally.[6] For example, if a U.S. citizen has bank accounts in the U.S., as well as in Switzerland, he or she must include all interest earned from the U.S. and Swiss banks on his or her Form 1040, line 8a.[7] Failure to claim the Swiss interest could lead to penalties and interest being assessed against the taxpayer. Further, the taxpayer is said to have filed a false return which means that there is no limit on the period of assessment; indeed, the Service can assess a tax against the taxpayer at any time and is not subject to the three (3) year statute of limitations.[8]

C. *Requirement 2: Acknowledgement of Foreign Bank Accounts*

In addition to the requirements of claiming and paying tax on foreign income, a U.S. citizen must also make disclosures on his or her Schedule B (Interest and Ordinary Dividends) regarding said account(s), which is attached to the individual's Form 1040.[9] Specifically, Part III (Foreign Accounts and Trusts) of Schedule B asks "[A]t any time during 2015, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in

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[5] 26 U.S.C. § 61(a) (2016).

[6] CCH TAX LAW EDITORS, U.S. MASTER TAX GUIDE # (99th ed. 2016); *see also* John Faucher, *Taking on Foreign Bank Account Reporting (FBAR) Fines & IRS Trolls,* FAUCHER LAW (Jan. 14, 2016), http://venturataxlawyer.com/taking-on-foreign-bank-account-reporting-fbar-fines-irs-trolls/ ("The U.S. is one of only two countries in the world that taxes their residents on foreign income. Eritrea is the other.")

[7] I.R.S. FORM 1040: U.S. INDIVIDUAL INCOME TAX RETURN, (2015), www.irs.gov/pub/irs-pdf/f1040.pdf.

[8] Ephraim SMITH, PHILIP HARMELINK & JAMES HASSELBACK, CCH FEDERAL TAXATION, COMPREHENSIVE TOPICS # (2015); *see also* Robert Wood, *10 IRS Rules for Stress-Free Foreign Accounts*, FORBES (April 19 ,2012, 6:06 AM), www.forbes.com/sites/robertwood/2012/04/18/10-irs-rules-for-stress-free-foreign-accounts/.

[9] I.R.S. SCHEDULE B: INTEREST AND ORDINARY DIVIDENDS (2016), http://www.irs.gov/pub/irs-pdf/f1040sb.pdf.

a foreign country?"[10] The taxpayer must then choose the correct box – either "Yes" or "No." If the answer to the foregoing is yes, then the taxpayer is asked if he or she is required to file FinCEN Form 114 (also known as the Report of Financial Accounts or FBAR) and if so, in what country.[11]

D. *Requirement 3: Filing of FBAR*

In addition to claiming worldwide income and acknowledging foreign accounts to the Service on the individual tax return, taxpayers with certain foreign accounts must also file Form FinCEN Form 114 (the "FBAR") with the Treasury Department by June 30 of the following year, and no extensions will be given.[12] The requirement to do so was brought about by the Bank Secrecy Act in 1970.[13] Under the Act and its underlying instructions and regulations, an FBAR must be filed where "(1) a U.S. person (2) had a financial interest in, signature authority over, or some other type of authority over (3) one or more financial accounts (4) located in a foreign country (5) and the aggregate value of such account or accounts exceeded $10,000 (6) at any time during the calendar year."[14]

Initially, the power to investigate and try FBAR violations rested with the Financial Crimes Enforcement Network ("FinCEN"); however, in April of 2003, the Treasury Department transferred that power to the Service.[15] In doing its duties, the Service can "investigate potential violations, issue summonses, assess civil penalties, issue administrative rulings and take 'any other action reasonably necessary' to enforce the FBAR rules."[16] For information as to penalties, see Section II.A.

E. *Filing of Form 8938 – Statement of Specified Foreign Financial Assets*

Not all taxpayers with foreign accounts must complete and file Form 8938; however, if a taxpayer is required to file Form 8938, he or she must attach it to his or her annual return and file it by the applicable due date with extension.[17] The instructions to Form 8938 provide that "you must file Form

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[10] *Id.* at Part III.
[11] *Id.*
[12] Wood, *supra* note 8.
[13] Hale E. Sheppard, *Third Time's the Charm: Government Finally Collects 'Willful' FBAR Penalty in Williams,* 117 J. TAX'N 1 (2012).
[14] *Id.* at 1.
[15] *Id.*
[16] *Id.*
[17] I.R.S. INSTRUCTIONS FOR FORM 8938: STATEMENT OF SPECIFIED FOREIGN FINANCIAL ASSETS (2016), http://www.irs.gov/pub/irs-pdf/i8938.pdf.

8938 if you are a specified individual that has an interest in specified foreign financial assets and the value of those assets is more than the applicable reporting threshold."[18]

A taxpayer is a specified individual if he or she is a U.S. citizen, resident alien or in some circumstances, a non-resident alien.[19] For taxpayers who live in the United States, the reporting thresholds differ depending upon filing status. If you are a married taxpayer filing a joint return, "you satisfy the reporting threshold only if the total value of your specified foreign financial assets is more than $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year."[20] If a taxpayer is an unmarried individual, then the reporting thresholds are "more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year."[21] On Form 8938, a taxpayer must report the maximum value of *each* foreign financial asset, which is generally its fair market value.[22]

Specified foreign financial assets include "financial accounts maintained by a foreign financial institution, … stock or securities issued by someone that is not a U.S. person, any interest in a foreign entity, and any financial instrument or contract that has an issuer or counterparty that is not a U.S. person."[23]

Failure to file a Form 8938 when required may result in a penalty of up to $10,000, which may increase due to non-compliance up to a maximum of $50,000.[24] Further, the filing of a Form 8938 with the Service does not relieve a taxpayer of the requirement to file a required FBAR.[25]

Taxpayers and tax preparers alike have found it difficult to determine if a taxpayer must file an FBAR, a Form 8938 or both. As such, the Service has posted a table which compares and contrasts the two forms side by side with several questions.[26] Generally speaking, an FBAR must be filed if foreign bank accounts exceed a certain amount, whereas Form 8938 requires a taxpayer to report an interest in foreign assets, including assets *other than* foreign bank accounts, over a certain amount.[27]

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[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.* (emphasis added.)
[23] *Id.*
[24] *Id.*
[25] *Id.*; *Comparison of Form 8938 and FBAR Requirements*, IRS.GOV (May 4, 2016), http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements.
[26] *Comparison of Form 8938 and FBAR Requirements*, *supra* note 25.
[27] *Id.* (emphasis added.)

II. BURDEN OF PROOF IN WILLFUL FBAR VIOLATION CASES

A. *Introduction*

As noted above,[28] one of the three (3) requirements for taxpayers with foreign accounts is the requirement, based on monetary amounts, to file an FBAR with the Treasury Department by June 30. Prior to 2004, the government could only assess civil penalties against taxpayers where it could show that the taxpayer 'willfully' violated the FBAR rules.[29] Those penalties ranged from $25,000 to $100,000 depending upon the highest balance in the account(s).[30]

However, the rules relating to FBAR violations changed in October of 2004 with passage of the American Jobs Creation Act ("AJCA").[31] Under its terms, the high "willful" standard was removed, and thereunder a taxpayer can be assessed civil penalties if he or she was required to file an FBAR and did not do so, unless the violation is due to reasonable cause.[32] So, there is no specific *mens rea* required – if a taxpayer was supposed to file and did not, then penalties can be assessed with no other questions asked or investigation necessary.

Further, the amount of the penalties assessed changed under the AJCA based on the parties' conduct. If the failure to file an FBAR was unintentional or non-willful, the highest fine which will be assessed is $10,000.[33] On the other end of the spectrum, where failure to file the FBAR is willful, the penalties were substantially increased. Specifically, the Service may "assert a penalty equal to $100,000 or 50% of the balance in the account at the time of the violation, whichever amount is larger."[34] Generally speaking, since most of these accounts far exceed $100,000, then the amounts penalized can be very substantial.[35] In addition, criminal penalties may also apply to the taxpayer who does not file a required FBAR.[36] As noted above, the power to investigate these violations was transferred to the Service in 2003.

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[28] *See* Section ID.
[29] Sheppard, *supra* note 13.
[30] *Id.*
[31] *Id.*
[32] *Id;* Hale E. Sheppard, *Government Wins Second Willful FBAR Penalty Case; What McBride Really Means for Taxpayers,* 118 J. TAX'N 1 (2013) (citing 31 U.S.C. § 5321(a)(b)(ii) (2004)).
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] *Comparison of Form 8938 and FBAR Requirements*, *supra* note 25.

B. *Statutory Law and Prior Precedent Relating to Burden of Proof*

In order to better understand how the Service investigates and assesses penalties for failure to file an FBAR, we must examine the statute in which such power is given. Further, in order to determine if the failure to file was willful, and in order to increase the penalties thereunder, we must examine the burden of proof required of the Service in these matters.

Specifically, under 31 U.S.C. § 5321(b)(2), entitled *Civil Penalties,* "the Secretary [of the Treasury] may commence a civil action to recover a civil penalty assessed under subsection (a) at any time before the end of the 2-year period beginning on the later of (A) the date the penalty was assessed; or (B) the date any judgment becomes final…." As noted above,[37] the penalties assessed under § 5321 depend upon the year in which the violations occurred (before or after 2004), and in the case of violations after 2004, whether the violation was willful or non-willful.[38] Indeed, under § 5321, enacted by Congress as part of the AJCA, does *NOT* set forth a specific legal standard to be applied by the judiciary in civil willful FBAR penalty cases.[39] Since Congress did not set forth such a standard, whether it be clear and convincing evidence or a preponderance of the evidence, it was up to the courts to determine one.

Specifically, in situations where Congress does not set the standard of proof, the Supreme Court in *Herman & Maclean v. Huddleston et al.,* has found that "we must prescribe one."[40] The *Huddleston* court further said that "we are mindful that a standard of proof serves to allocate the risk of error between the litigants and to indicate the relative importance attached to the ultimate decision."[41] As to which was the proper standard to apply, the *Huddleston* court said that "we have required proof by clear and convincing evidence where particularly important individual interests or rights are at stake."[42] In its analysis, the *Huddleston* court counted termination of parental rights, involuntary commitment proceedings and deportation as particularly

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[37] *See* Section II A.

[38] *Internal Revenue Manual 5.21.6 Foreign Financial Account Reporting*, IRS.GOV (Feb. 18, 2016), https://www.irs.gov/irm/part5/irm_05-021-006.html (citing 31 U.S.C. § 5321 (a)(5)(C) (willful) and 31 U.S.C. §5321(a)(5)(A) &(B) (non-willful)).

[39] *FBAR Reasonable Cause,* BRAGER TAX LAW GROUP (2012), https://www.bragertaxlaw.com/previously-unrelased-irs-guidelines-for-fbar-audits.html (emphasis added).

[40] Herman & Maclean v. Huddleston, 459 U.S. 375, 389 (1983) (citing Steadman v. SEC, 450 U.S. 91, 95 (1981); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 749 (1975)).

[41] *Huddleston.,* 459 U.S. at 389 (citing Addington v. Texas*,* 441 U.S. 418, 423 (1979); In re Winship*,* 397 U.S. 358, 370-71 (1970) (Harlan, J., concurring)).

[42] *Huddleston,* 459 U.S. at 389-90.

important individual interests or rights that would require the use of the clear and convincing standard.[43]

On the other hand, the *Huddleston* court found that "imposition of even severe civil sanctions that do not implicate such [particularly important] interests has been permitted after proof by a preponderance of the evidence."[44] In its explanation, the *Huddleston* court included civil suits that expose a party to criminal prosecution and antifraud provisions, which could lead to loss of profession, and findings of fraud under the 1933 Act as cases where the preponderance of the evidence standard was used.[45] It found that the preponderance of the evidence standard "allows both parties to share the risk of error in roughly equal fashion (and that) any other standard expresses a preference for one side's interests."[46] As to which standard would be applied in civil willful FBAR penalty cases, it would be left up to the first court(s) to hear such a case.

C. *Willful FBAR Penalty Cases – Williams and McBride*

In what has become known as the *Williams* trilogy, the judicial system had its first look at the civil willful FBAR penalty.[47] In *Williams,* the taxpayer was a New York University educated lawyer who worked for an international corporation.[48] The taxpayer opened two foreign accounts which "were designed to hold funds earned from 1993 through 2000 in connection with his oil trading in Russia and his consulting for various companies."[49] During this time, he had a U.S. accountant, but never mentioned these

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[43] *Id.* (citing Santosky v. Kramer*,* 455 U.S. 745 (1982) (proceeding to terminate parental rights); *Addington,* 441 U.S. at 423 (1979) (involuntary commitment proceeding); Woodby v. INS, 385 U.S. 276, 285-86 (1966) (deportation)); Master-Halco, Inc. v. Scillia, Dowling & Natarelli, LLC, 739 F.Supp.2d 109 (2010) (following *Huddleston* in applying preponderance of the evidence standard with securities fraud); Octane Fitness, LLC v. Icon Health & Fitness, Inc., 134 S.Ct. 1749 (2014) (following *Huddleston* in applying preponderance of the evidence standard to patent infringement); Grogan v. Garner, 498 U.S. 279 (1991) (following *Huddleston* in applying preponderance of the evidence standard to bankruptcy code discharge exceptions).

[44] *Huddleston*, 459 U.S. at 390.

[45] *Id.* (citing United Sates v. Regan, 232 U.S. 37, 48-49 (1914) (proof by a preponderance of the evidence suffices in civil suits involving proof of acts that expose a party to a criminal proceeding)); *Steadman*, 450 U.S. at 95 (upheld the use of the preponderance standard in SEC administrative proceedings concerning alleged violations of the antifraud provisions); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 355 (1943) (preponderance of the evidence suffices to establish fraud under § 17(a) of the 1933 Act).

[46] *Huddleston*, 459 U.S. at 390 (citing *Addington,* 441 U.S. at 423).

[47] Sheppard, *supra* note 32.

[48] *Id.*

[49] *Id.*

foreign accounts.[50] In June 2001, he met with U.S. tax attorneys and tried to enroll in the OVDP, but was rejected because the program was not available to those taxpayers whom the Service had already initiated a civil or criminal investigation, or if they had received notice from a third party of a taxpayer's non-compliance.[51] In May 2003, the taxpayer plead guilty to one count of criminal tax evasion and one count of criminal conspiracy.[52] As such, he was sentenced to almost four (4) years in jail, three (3) years of supervised release, a $25,000 fine and $3.5 million in restitution.[53] One year later, the Service decide to initiate a civil examination against the taxpayer for failure to file FBARs.[54]

At the district court level, the court addressed the Service's burden of proof in civil willful FBAR cases. Specifically, the court found that the Service's burden of proof was preponderance of the evidence on all questions, "including the question of whether the taxpayer's failure to report in that case was 'willful.'"[55]

In *U.S. v. McBride,* the U.S. District court for the Central Division of Utah, revisited the burden of proof in civil willful FBAR penalty cases.[56] In *McBride,* the taxpayer was a member in an LLC that sold phone belt accessories.[57] Since his company was very profitable, he began to seek out ways to reduce his income and as such became associated with Merrill Scott and Associates (MSA) in 1999.[58] In exchange for $75,000 and monthly fees thereafter, MSA developed a Financial Master Plan for the taxpayer which included the formation of four (4) foreign entities and a plan for illegally reducing its U.S. profits.[59] After a review, an IRS revenue agent asserted a total civil willful FBAR penalty of $200,000.[60]

In its analysis, the federal district court in *McBride,* directly addressed the Service's burden of proof in civil willful FBAR penalty cases. The

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[50] *Id.*
[51] *Id.*
[52] *Id.*
[53] *Id.*
[54] *Id.*
[55] *FBAR Reasonable Cause, supra* note 39 (citing United States v. Williams*,* No. 1:09-cv-435, 2010 WL 3473311 (E.D. Va. Sep. 1, 2010), *rev'd on other grounds,* 489 F. App. 655 (4th Cir. 2012).
[56] United States v. McBride, 908 F.Supp.2d 1186, (D. Utah 2012).
[57] Sheppard, *supra* note 32.
[58] *Id.*
[59] *Id.* (Taxpayer's company, called the Clip Company, entered into agreements with its Taiwanese manufacturer in which the Clip Company would overpay them, thereby increasing its cost of goods sold and reducing its income. Then, under the agreement, the Taiwanese manufacturer would send the overpayment to a bank account in the Bahamas owned by one of the taxpayer's foreign entities developed under the Financial Master Plan.)
[60] *Id.*

McBride court noted that 31 U.S.C. § 5321(b)(2) does not specify the legal standard to be applied.[61] Next, it found that "[t]he one district court that has directly addressed the question of the burden of proof in a civil FBAR penalty case, *U.S. v. Williams,* concluded that the United States' burden of proof was "the preponderance of the evidence" on all questions …, including the question of whether the taxpayer's failure to report in that case was willful."[62] In its decision, the court found "[t]he preponderance of the evidence standard applied by the district court in *Williams* is the correct standard."[63] Next, the Court cited *Huddleston,* stating that "as with government penalty enforcement and collection cases generally, absent a statute that prescribes the burden of proof, imposition of a higher burden of proof is warranted only where 'particularly important individual interests or rights,' are at stake."[64] Most importantly, "[b]ecause the FBAR penalties at issue in this case only involve money, it does not involve 'particularly important individual interests or rights' as that phrase is used in *Huddleston* and *Grogan*."[65]

Next, the court noted that *Huddleston's* logic had been previously applied in civil tax penalty cases,[66] and that "the Supreme Court has been unwilling to require that litigants meet a higher burden of proof than the preponderance of the evidence standard where the statute does not specify a higher standard of proof."[67] The *McBride* court again noted that in the statutory sections at issue that "[c]ongress did not specify any special, heightened standard of proof. As a result, there is no reason to deviate from the default burden of proof applicable in civil cases."[68] Finally, the court found that the U.S. "bears the burden of proving that McBride willfully failed to file FBARs with respect to the accounts at issue by the preponderance of the evidence."[69]

Therefore, the two federal district courts that have addressed the issue, one in the 4th Circuit and one in the 10th circuit, have both concluded that the Service's burden of proof in civil willful FBAR penalty cases is a mere preponderance of the evidence. However, some commentators have

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[61] *McBride,* 908 F.Supp.2d at 1201.
[62] *Id.* (citing United States v. Williams*,* No. 10-2230, 489 Fed.App. 655, No. 10-2230, 2012 WL 2948567 (4th Cir. Jul 20, 2012)).
[63] *McBride,* 908 F.Supp.2d at 1201.
[64] *Id.* (citing Herman & Maclean v. Huddleston at 389; Grogan v. Garner*,* 498 U.S. 279, 286 (1991)).
[65] *McBride,* 908 F.Supp.2d at 1201.
[66] *Id.* (citing Mattingly v. U.S.*,* 924 F.2d 785, 787 (8th Cir. 1991)).
[67] *McBride,* 908 F.Supp.2d at 1202, (citing Grogan, 498 U.S. at 286).
[68] *McBride,* 908 F.Supp.2d at 1202.
[69] *Id.*

questioned whether a higher standard should apply, and at least one taxpayer has so argued.[70]

III. BERNHARD GUBSER'S DECLARATORY JUDGMENT ACTION

A. *Introduction*

To that point, on December 15, 2015, in the U.S. District Court for the Southern District of Texas (Laredo Division), Bernhard Gubser brought a declaratory judgment action against the Service asking that the Court declare that the Service be required to establish willful violations of the FBAR filing requirement by clear and convincing evidence, rather than by a preponderance of the evidence, when seeking to impose civil willful FBAR penalties.[71]

B. *Factual Background*

Bernhard Gubser is a sixty-six (66) year old Swiss citizen, who has the equivalent of a ninth grade education, and who worked with the railroad system in Switzerland most of his life.[72] While working in the transportation business, Mr. Gubser went to Mexico and the U.S. Later, Gubser became a transportation manager of an import-export company in Laredo, Texas, called Transmaritime, Inc. and has been there since 1982.[73] Thereafter, Mr. Gubser became a naturalized U.S. citizen in 1992 and planned to return to his home country of Switzerland upon his retirement.[74]

While working in the U.S., Gubser kept bank accounts that he jointly owned with his wife Heidi, in Switzerland at UBS AG, a large Swiss bank, which consisted of his retirement savings from working on the Swiss railroad[75] and which he used while working in Switzerland.[76] Upon their divorce in 2008, the funds in the Swiss UBS accounts were "equally divided

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[70] Faucher, *supra* note 6; *see also* Sheppard, *supra* note 32; *infra* Section III.
[71] Plaintiff's Complaint for Declaratory Judgment at 13, Gubser v. Comm'r, 2016 WL 3129530 (S.D. Tex. 2016) (CIVIL ACTION NO. 5:15-cv-298), 2015 WL 9258729; *See* John Letzing, *Swiss-Banking Lawsuit Against IRS Could Have Wide Impact,* WSJ (Dec. 17, 2015, 12:55PM), www.wsj.com/articles/swiss-banking-lawsuit-against-irs-could-have-wide-impact-1450374899 (In 2012, Gubser was a Plaintiff in a complaint filed by UBS clients who argued that the bank breached its duties of confidentiality…. The case was dismissed in 2014.).
[72] Plaintiff's Complaint, *supra* note 71, at 10; Faucher, *supra* note 6.
[73] Plaintiff's Complaint, *supra* note 71, at 10; Faucher, *supra* note 6; Letzing, *supra* note 71.
[74] Plaintiff's Complaint, *supra* note 71, at 10.
[75] Faucher, *supra* note 6; ("[Gubser] always put part of his U.S. earnings into his Swiss bank account.").
[76] Plaintiff's Complaint, *supra* note 71, at 10.

and transferred to two newly opened accounts at Bank Julius Baer Co. Ltd. ("Julius Baer") in Switzerland."[77] According to the Gubser's Complaint for Declaratory Judgment (the "Complaint"), the highest balance in Mr. Gubser's Julius Baer account in 2008 was $2,726,672.[78] At no time did Gubser conceal these accounts using a foreign entity or the like.[79] In that same year, the U.S. Justice Department started prosecuting Swiss banks with American clients.[80] Further, in 2009, in a settlement agreement, UBS admitted helping Americans hide assets in Switzerland, paid $780 million and in 2010, UBS divulged the identities of 4,450 of its American clients with undeclared accounts – Gubser was one of them.[81]

According to the Complaint, Gubser's U.S. tax returns were filed by his certified public accountant, Ernesto Dominguez, and had been for at least twenty (20) years before 2008.[82] In 2008, Gubser did not know of the requirement to file an FBAR and was not asked by Dominguez if he had any foreign bank accounts; instead, according to the Complaint, Dominguez prepared the 2008 return and automatically checked "No" to the box inquiring of foreign bank accounts.[83] In 2010, Gubser became aware of the requirement to file FBARs for foreign bank accounts and at that time, he "immediately and timely filed his FBAR for 2009" and has done so for all years thereafter.[84]

In 2008, Gubser made a voluntary disclosure under the Offshore Voluntary Disclosure Program (the "OVDP") for 2003-2010 in order to voluntarily disclose his failure to file FBARs.[85] Gubser was accepted into the program, but ultimately opted out of the OVDP penalty framework in January of 2014.[86] Thereafter, on March 30, 2014, Gubser received Letter 3709 (the "FBAR 30 Day Letter) which notified him that he had not filed an FBAR in 2008 and that the penalty for such a willful violation would be equal to fifty percent (50%) of the balance of the account(s) at that time.[87] On May 1, 2015, he appealed the penalty and requested a hearing before the IRS Office of Appeals.[88]

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[77] *Id.*
[78] *Id.*
[79] *Id.*
[80] Letzing, *supra* note 71.
[81] *Id.*
[82] Plaintiff's Complaint, *supra* note 71, at 10-11.
[83] *Id.* at 11.
[84] *Id*; *see* Letzing, *supra* note 71 (It was too late for him to make a filing for 2008, and the six-year statute of limitations prevents the Service from pursuing him for tax years before 2008.).
[85] Plaintiff's Complaint, *supra* note 71 at 11.
[86] *Id.* The Complaint does not go into any details about why this was done.
[87] *Id.*
[88] *Id.*

On September 10, 2015, Gubser's attorneys met with an IRS Appeals officer and according to the Complaint, the IRS Appeals officer stated that "if the IRS were required to establish Gubser's willful failure to file by clear and convincing evidence, the IRS would not be able to meet its burden," but if the "IRS were required to establish Gubser's willful failure to file by a preponderance of the evidence, the IRS Appeals officer believed that the IRS would likely be able to meet its burden."[89] As such, the IRS Appeals officer, relying on IRS training materials, asserted that the government's burden to prove a willful FBAR violation was merely a preponderance of the evidence.[90] Further, as discussed above,[91] the government has taken that approach in cases such as *U.S. v. Williams* and *U.S. v. McBride.*

C. *Gubser's Argument for Changing the Burden of Proof*

In his Complaint, Gubser initially distinguishes between criminal tax fraud and civil failure to file a return.[92] Gubser notes that criminal tax fraud requires that the failure to file the return or pay the tax must have been willful, whereas the civil failure to file a return or pay the tax does not contain willfulness.[93] Then, Gubser argues that "[i]n between the criminal provisions and the civil provisions, Congress placed the quasi-criminal provisions such as civil fraud and willful FBAR penalties."[94]

In his argument, Gubser contends that civil tax fraud must be proven by clear and convincing evidence,[95] and equates willful FBAR cases with civil tax fraud. To further his argument, Gubser notes that the civil tax fraud penalty, which is 75% of the tax defrauded, and the willful FBAR penalty, which is 50% of the highest balance in the account, are both significant monetary penalties. As such, Gubser makes his argument that the government must prove a willful FBAR violation by clear and convincing evidence.

To further his argument, Gubser thinks it is important and relevant that after what he calls the "quasi-criminal penalty" for willful FBAR violations was established, that Congress established a lesser civil penalty for non-willful violations of the FBAR.[96] As discussed above, before 2004, statutory

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[89] *Id.* at page 12.
[90] *Id.* at page 12 (citing IRS, *FBAR Penalty Case Workshop, OVDI Opt-Out & Removal Part 1 of 2*, BRAGER TAX LAW (May 30, 2013), http://pdfs.taxnotes.com/2014/2014-27973-1.pdf.").
[91] *See supra* Section II A.
[92] Plaintiff's Complaint, *supra* note 71, at 6-7.
[93] *Id.*
[94] *Id.* at 7.
[95] *Id.* at 7 (citing Tax Ct. R. 142(b)).
[96] Plaintiff's Complaint, *surpa* note 71, at 8.

law contained only a willful FBAR civil penalty.[97] With passage of the AJCA, Congress created the non-willful FBAR penalty, due in part to difficulty in proving the failure to file the FBAR was willful.[98] As such, Gubser's argument is that Congress understood the difficulties in proving willful failures to file, and therefore implied that there were different burdens of proof.

Finally, Gubser points to an internal memorandum from the Service in 2006, in which the question was asked if "with respect to the willfulness issue, is whether the criteria for assertion of the civil FBAR penalty are the same as the burden of proof that the Service has when asserting the civil fraud penalty under IRS § 6663."[99] Notably, the Memorandum found:

> We expect that a court will find the burden in civil FBAR cases to be that of providing 'clear and convincing evidence,' rather than merely a 'preponderance of the evidence.' The clear and convincing evidence standard is the same burden the Service must meet with respect to civil tax fraud cases where the Service also has to show the intent of the taxpayer at the time of the violation. Courts have traditionally applied the clear and convincing evidence standard with respect to fraud cases in general, not just to tax fraud cases, because, just as it is difficult to show intent, it is also difficult to show a lack of intent. The higher standard of clear and convincing evidence offers some protection for an individual who may be wrongly accused of fraud.[100]

The Memorandum then discusses that the presumption of correctness in tax cases and how it does not apply here; specifically stating "[b]ecause the FBAR penalty is not a tax or a tax penalty, the presumption of correctness with respect to tax assessments would not apply to an FBAR penalty assessment for a willful violation – another reason we believe that the Service will need to meet the higher standard of clear and convincing evidence."[101]

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[97] *Id.*
[98] *Id.*
[99] I.R.S. Chief Couns. Mem. 200603026 (Jan. 20, 2006).
[100] *Id*. at 3.
[101] *Id.* at 3 (citing footnote 2 of United States v. Dollar Bank Money Mkt. Account, 980 F.2d 233 (3rd Cir. 1992)).

D. *Discussion, Analysis and Conclusion*

Obviously, before the Texas federal district court can rule on the issue of whether the burden of proof in civil FBAR penalty cases is either by a preponderance of the evidence or by clear and convincing evidence, it must first be fully satisfied that the case is ripe for review. It is important to note but since the initial filing of Gubser's Complaint, the Service filed a Motion to Dismiss Plaintiff's Complaint (the "Motion to Dismiss") on February 25, 2016. In its Motion to Dismiss, the Service asserts that the Court does not have subject matter jurisdiction because "there has been no waiver of sovereign immunity; the Plaintiff lacks standing; and the Declaratory Judgment Act relied on by Plaintiff does not provide an exception to these requirements."[102] Gubser responded to the Motion to Dismiss on March 17, 2016 and the parties are awaiting a ruling.

Assuming the Court dismisses the Service's Motion to Dismiss, it will first look at the statute that authorized the assessment, and they, like the previous courts, will note that it does not set a burden of proof. Next, it will see that according to case law, it can set the burden of proof. At this point, the Court will have to look at its own precedent in the area, of which there is none – then, it will extend to looking at similar rulings in other circuit courts. As discussed above, *Williams* was decided by the 4th Circuit and *McBride* by a Utah district court which sits in the 10th Circuit; while these cases are not binding authority on the Texas court, they are persuasive.

In my opinion, it should be concerning that the Service has drastically changed its stance on this issue from 2006 to now. In its own internal documents in 2006, the Service concluded that the burden of proof in willful FBAR cases should be clear and convincing evidence due to its similarity to civil tax fraud, in which that standard is applied, and because it is not a tax or a tax penalty (but a civil one). However, as the Service noted in a brief during the *McBride* case:

> McBride may not cite to Internal Revenue Service Legal Memorandum [because] 26 U.S.C. § 6110 specifically prohibits Chief Counsel Advice memoranda like the one mentioned by counsel for McBride from being either used or cited as precedent. Therefore, that memorandum has no controlling effect, and moreover should not have any persuasive value….[103]

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[102] United States of America's Motion to Dismiss Plaintiff's Complaint for Declaratory Judgment and Brief, Gubser v. Comm'r, 2016 WL 3129530 (S.D. Tex. 2016) (CIVIL ACTION NO. 5:15-cv-298), 2016 WL 2586854.

[103] Sheppard, *supra* note 13 (citing Plaintiff's Trial Brief, at 8-9, United States v. McBride, 908 F.Supp.2d 1186 (2012) (No.2:09-cv-378-DN), 2012 WL 9494662).

Further, in seeking to distance itself from the infamous 2006 memorandum, in January of 2013, a high-ranking attorney with the IRS stated "[t]he IRS office of Chief Counsel initially took a conservative position when it advised field agents on the standard of proof that the government must satisfy to show willfulness for the FBAR penalty, in part because the issue had not been litigated. But the courts have since agreed with the IRS that preponderance of the evidence, rather than clear and convincing evidence, is the correct standard…"[104]

Although the Service's internal documents cannot be used as precedent, the existence of such a document bolsters Gubser's argument. However, based on Supreme Court precedent established in *Huddleston,* the clear and convincing standard is reserved for cases where "particularly important individual interests or rights are at stake," and that does not include the "imposition of even severe civil sanctions."[105] Further, even though Gubser equates willful FBAR penalty cases with civil tax fraud, no court has done the same and there is no guarantee that this court will do so.

In my opinion, one thing that sets apart the willful FBAR penalty cases from the civil tax fraud cases, is that the latter is a tax and the former is only a penalty. Therefore, an implication that these two (2) subjects are similar and should be judged the same way may not be correct. As such, I believe that the Texas federal district court will ultimately look back at the *Huddleston* case and its successors and find that since this is a penalty and not a tax, and since Congress did not specify that a higher burden of proof should be used in these types of cases, that the default burden of proof in civil cases should apply, which is that the Service must prove civil willful FBAR penalty cases by only a preponderance of the evidence. In conclusion, I think that the court will rule against Gubser and not declare that the burden of proof should be one of clear and convincing evidence.

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[104] Sheppard, *supra* note 13 (citing Jeremiah Coder, TAXPAYERS FACE HURDLES AND RISKS WHEN OPTING OUT OF OVDP, TAX ANALYSTS (2013), https://d3n8a8pro7vhmx.cloudfront.net/kflaw/pages/772/attachments/original/1437166448/3D58F68BF4DA1C29101C6A580FF54F73.pdf?1437166448).

[105] *See supra*, Section II B.