IN CASE YOU MISSED IT – July 2021

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Almost every day, federal and state courts issue opinions that affect taxpayers. The IRS and state taxing authorities also publish guidance on myriad topics.

Each month, this column will review a selection of recent court cases or guidance that tax professionals should know about when advising their clients and preparing tax returns.

For more extensive detail on any of these items, please feel free to reach out to the author.

U.S. v. Kronowitz – CPA must pay FBAR willful penalty

This case involved an attempt by the Government to collect outstanding civil penalties that were previously assessed against Kenneth G. Kronowitz for his willful failure to report his financial interest in foreign bank accounts (i.e., the failure to file FBARs), as required by 31 U.S.C. § 3514 for the years 2005–2010. Unlike many of the FBAR lawsuits that are appearing on almost a daily basis in the courts, Kronowitz was a certified public accountant who prepared his own tax returns.

The Government alleged that he had bank accounts in both the Cayman Islands and Switzerland, some dating as far back as 2001, which he failed to report.

Kronowitz was born in 1937, obtained a bachelor's degree in accounting from the University of Miami in 1961, worked for an accounting firm for two years and then began his own accounting practice. He has practiced as a sole practitioner since then, mainly servicing individuals and small local businesses. Kronowitz has been preparing tax returns since he got his degree, and although he has slowed down in the last decade, he still prepares a dozen or so returns each year.

Like all certified public accountants, he had to take many courses in continuing professional education ("CPE"). Although he took CPE classes called Tax Shelter Seminar, Foreign Taxation, Offshore Trusts, and Asset Protection/Estate Planning, he testified that he did not recall the FBAR being specifically mentioned in any of his classes.

Based upon the advice he received at one CPE course that said that professionals should move assets offshore for protection, and the rumor that a former client of his was going to sue him for fraud, Kronowitz opened two bank accounts in the Cayman Islands in 2001 to keep funds out of the reach of potential creditors. Kronowitz had signature authority over—and was the financial beneficiary of—the Cayman accounts.

In addition, one of his clients, a real estate developer, provided Kronowitz the opportunity to buy a small interest in a few foreign development projects as a reward for good service. Kronowitz gave the client a check for his investment, but claimed that he never received any paperwork documenting his investment or any other proof of his ownership interest. His sole record of his investment and return thereon was a yellow legal pad on which he kept track of the funds invested and the funds received. During the trial, however, evidence was presented that he had signed an agreement with a Liechtenstein company to manage a foreign foundation with respect to its Swiss bank accounts. The documents showed that he was the beneficial owner of the foreign foundation and his wife and children were named the successor beneficiaries. Kronowitz testified that his real estate client must have established the foundation without his knowledge, as he did not believe that he signed any such documents.

The Government established that the foreign foundation opened an account at United Bank of Switzerland in 2005 which listed Kronowitz as the beneficial owner, and that in 2009 these funds were transferred to an account at Basler Kantonalbank that also listed him as the beneficial owner.

By 2008, the foreign real estate investments had generated significant gains. Kronowitz told the Liechtenstein management company that he wanted his proceeds from the investments sent to his bank account in the Caymans. He again sent a direction letter in 2009 to have funds transferred to his Cayman account, and then in 2010 he asked that the Lichtenstein company "liquidate my account and forward all moneys as you did before to my account in the [C]aymans." The funds were then transferred each year to a trust account in the United States. In all three years, Kronowitz had the trust report and pay U.S. income tax on the gain that he calculated was earned on the foreign investments.

Although Kronowitz was required to include Schedule B with his individual federal income tax return to report interest and dividend income each year, he only included one with his 2008 return. On that 2008 Schedule B, in response to the question asking "[a]t any time during 2008, did you have an interest in or signature or other authority over a financial account in a foreign country, such as a bank account, securities account or other financial account?" Kronowitz marked "no." When questioned about this at trial, Kronowitz admitted that although he had seen hundreds of Schedule Bs over the course of his career, he does not recall ever reading the instructions to the Schedule, as he was "an accountant and not an attorney."

He also admitted that as a return preparer, he was aware of the question asking about interests in foreign accounts, but that he had never researched what that question was really asking and did not know what the Form number TDF 90-22.1 referenced on the Schedule Bs was referring to. He testified that he had did not know that he was considered to be a beneficial owner of the bank accounts at United Bank of Switzerland and Basler Kantonalbank until the IRS audited him in 2011 (although he was fully aware that he had signature authority over and beneficial interest in the Cayman accounts). Kronowitz mistakenly believed that he had complied with all of his tax obligations because he had reported the income from his foreign investments. He did not believe there were any separate filing requirements for the existence of the foreign bank accounts.

The Service determined that his failure to file FBARs disclosing his interest in the foreign bank accounts during 2005 through 2010 was a willful violation, and assessed penalties thereon. By the date of this court proceeding, the total owed, including interest and assessed penalty fees, was $753,680.37.

The Bank Secrecy Act (BSA) was passed in 1970 to require the making of certain reports that "have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings." The regulations promulgated thereunder require "each United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country" to file an FBAR ... "with respect to foreign financial accounts exceeding $10,000 maintained during the previous calendar year." *See* 31 C.F.R. § 1010.306(c). *See* 31 C.F.R. § 1010.350(a).

There have been numerous cases in recent years on the question of what it means to willfully fail to file an FBAR. The United States Court of Appeals for the Eleventh Circuit recently held that "willfulness in the § 5321 includes reckless disregard of a known or obvious risk" in *United States v. Rum*., Similarly, the Third Circuit has been repeatedly quoted for saying in **Bedrosian v. United States** "when imposing a civil penalty for an FBAR violation, willfulness based on recklessness is established if the defendant (1) clearly ought to have known that (2) there was a grave risk that an accurate FBAR was not being filed and if (3) he was in a position to find out for certain very easily.". The Government believes that if a taxpayer filed a return with the "no" box checked on Schedule B, that is enough to show that the taxpayer had the requisite knowledge that an FBAR was required and thus the failure to file one must have been willful.

The court found that Kronowitz's failure to file FBARs reporting his interest in foreign bank accounts was willful as he was a professional tax return preparer for nearly 60 years who, until recently, prepared approximately three dozen tax returns per year, saw hundreds of Schedule Bs, and admitted to being familiar with the purpose of Schedule B and its requirements, even though he testified that he probably did not read the Schedule B instructions because "my purpose in life at the time was to get clients, bill them, and collect the money, not spending the whole year reading." The Court held that he clearly ought to have known that there was a grave risk that he was failing to comply with the FBAR requirements with respect to his foreign accounts.

Kronowitz simply and incorrectly assumed that reporting the gains from his foreign investments would satisfy all of his tax reporting obligations. He conducted no research, and the court faulted him for failing to ask anyone with more expertise in the area about possible additional filing requirements.

Although Kronowitz insisted that there was no intent to defraud the IRS, fraudulent intent is not an element in a finding of willfulness for failure to file an FBAR.

Taxpayer after taxpayer have argued in the numerous FBAR cases that that they did not read their return and simply signed on page 2 where indicated by their return preparer. Until the last 10 years, many accountants did not even ask their clients if they had any foreign bank accounts. Regardless, the courts have held time after time that they are liable for having knowledge of every entry shown on the return.

Thus, it was no surprise that in this case, the taxpayer, a certified public accountant and return preparer, who has been filling out Schedule Bs for both his own personal returns and for dozens of clients for almost 60 years, was found to be willful. If someone with no knowledge of taxes is deemed to know everything on a tax return, how could he have been held to a lesser standard?

Takeaway: Practitioners have long believed that the courts are going too far in finding willfulness to exist in the FBAR context. Some of the circuit court decisions are finally being appealed to the Supreme Court. It will be interesting to see if the Supreme Court will change the trajectory these cases are taking.

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