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Legal Sidebar

Supreme Court Rules Against IRS on Foreign Account Reporting Penalties

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Federal law requires U.S. persons with a financial interest in or signature or other authority over foreign financial accounts totaling more than $10,000 to report these accounts by filing a Report of Foreign Bank and Financial Accounts, commonly known as an FBAR, each year. The IRS may levy civil penalties of up to $10,000 for each non-willful violation of the reporting requirement. On February 28, 2023, the U.S. Supreme Court held that this maximum penalty applies to each untimely or inaccurate annual FBAR form, rather than to each foreign account not properly reported. In the case before the Court, the IRS had assessed $2.72 million in per-account penalties based on five years of untimely FBAR forms. The Court's holding limits the maximum total penalty that may be assessed for those five untimely filings to $50,000, or $10,000 for each untimely annual report. This Legal Sidebar discusses the relevant penalty provisions and analyzes the Court's decision.

Reporting Requirements

Congress enacted the Bank Secrecy Act (BSA) in part to address the serious and widespread use of foreign financial institutions to evade domestic criminal, tax, and regulatory requirements. The BSA requires U.S. citizens, residents, and entities to report—independent of any tax obligations—certain foreign financial transactions, relationships, and accounts. One provision of the BSA, 31 U.S.C. § 5314, establishes the reporting requirements, empowering the Secretary of the Treasury to adopt implementing regulations. One of the regulations adopted by the Secretary, 31 C.F.R. § 1010.350, requires U.S. persons with a financial interest in or signature or other authority over foreign financial accounts totaling more than $10,000 to file an FBAR each year listing details regarding all foreign accounts. For individuals with more than 25 foreign accounts, Section 1010.350 requires them to provide more limited information on the FBAR and have the detailed information concerning each account available on request.

Congress amended the BSA in 1986, giving the Secretary of the Treasury authority to impose civil penalties for willful violations of Section 5314, including foreign account reporting requirements. In the American Jobs Creation Act of 2004, Congress expanded the available penalties to reach non-willful violations.

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The civil penalties section as amended (31 U.S.C. § 5321(a)(5)) provides that the Secretary may impose a penalty "on any person who violates, or causes any violation of, any provision of section 5314." For non-willful violations, "the amount of any civil penalty imposed . . . shall not exceed $10,000." If any violation is due to reasonable cause and "the amount of the transaction or balance in the account at the time of the transaction was properly reported," no penalty shall be imposed. For willful violations, the maximum penalty is "the greater of $100,000 or 50 percent of the amount determined under subparagraph (D)." Subparagraph (D) provides that, "in the case of a violation involving a failure to report the existence of an account" or related identifying information, the relevant amount is the balance in the account at the time of violation. The maximum penalty for a willful violation is thus the greater of $100,000 or 50% of the balance of the account at the time of violation. The reasonable cause exception does not apply to willful violations. The IRS must assess any civil penalty, willful or non-willful, within six years of the violation. For violations occurring after November 2, 2015, the maximum penalty values are adjusted for inflation.

Prior to the Supreme Court's decision, the IRS interpreted both the $10,000 maximum penalty for non-willful violations and the $100,000 element of the maximum penalty for willful violations as applying on a per-account basis, that is, to each unreported or improperly reported foreign account. Several foreign account holders accused of non-willful violations challenged the IRS's position, arguing that the maximum penalty for non-willful violations applies on a per-report (or per-form) basis, so that the maximum penalty for non-willfully failing to file an accurate FBAR in any particular year is $10,000, regardless of the number of foreign accounts the regulations required the defendant to report.

The U.S. Court of Appeals for the Ninth Circuit agreed with a defendant in one such case and adopted the per-report interpretation. In *United States v. Bittner*, the U.S. Court of Appeals for the Fifth Circuit endorsed the per-account interpretation urged by the IRS. Bittner successfully petitioned for a writ of certiorari to the U.S. Supreme Court. These developments were discussed in a prior Legal Sidebar.

United States v. Bittner

Alexandru Bittner was born in Romania and became a naturalized citizen of the United States in 1987. He returned to Romania in 1990 and became a successful businessman with numerous financial accounts in several European countries. Bittner learned of his FBAR obligations on returning to the United States in 2011, at which time he filed the required FBAR forms. The IRS assessed $2.72 million in penalties for 272 non-willful violations based on Bittner's failure to report between 51 and 61 accounts that were open in each of the five years—2007 through 2011—for which penalties could still be levied. In other words, the IRS assessed the maximum $10,000 penalty for each of the 272 accounts that Bittner should have reported on five untimely filed FBAR forms. Bittner challenged the IRS's penalty assessment, and a federal district court ruled in his favor, adopting the per-report interpretation of the penalty provisions. The Fifth Circuit reversed, upholding the IRS's assessment.

The Supreme Court, in a 5-4 decision, held that non-willfully failing to file a timely or accurate FBAR form is a single violation of the BSA subject to a maximum penalty of $10,000. Justice Gorsuch wrote the opinion for the Court adopting the per-report interpretation, joined by Chief Justice Roberts and Justices Alito, Kavanaugh, and Jackson. As discussed further below, Justice Gorsuch's opinion included a section discussing the rule of lenity joined only by Justice Jackson. Justice Barrett dissented, joined by Justices Thomas, Sotomayor, and Kagan.

Majority Opinion

The majority concluded that the per-report approach is the best reading of the BSA. Justice Gorsuch began with the text of Section 5314. He explained that the text "does not speak of accounts or their

number," and that the word "account" does not appear. In his view, the section creates a binary obligation where one "either files a report 'in the way and to the extent the Secretary prescribes,' or one does not."

Turning to the non-willful penalty provision of Section 5321, Justice Gorsuch again emphasized the lack of any use of the term "account." Instead, the statutory maximum penalty is tied to a violation, which Justice Gorsuch identified as the binary, per-report obligation.

Justice Gorsuch next rejected the government's arguments that the account-based elements of the willful penalty provisions and the reasonable cause exception supported the IRS's interpretation. He invoked the *expresio unius* canon of construction, which he framed as providing that "[w]hen Congress includes particular language in one section of a statute but omits it from a neighbor, we normally understand that difference in language to convey a difference in meaning." He thus understood the contrast between the absence of account-specific language in the non-willful penalty provision and the presence of such language elsewhere in Section 5321 to indicate that Congress did not intend the non-willful penalty to apply on a per-account basis. He found additional support in the drafting history of the section, because the non-willful penalty provision was added to Section 5321 after the willful penalties.

Justice Gorsuch then addressed Department of the Treasury and IRS documents describing FBAR penalties, collecting several such documents that use language consistent with the per-report interpretation of the non-willful maximum penalty. He explained that while these guidance documents could not control the Court's analysis, the Court could weigh them in assessing the persuasiveness of the government's contrary interpretation, citing *Skidmore v. Swift & Co*. Justice Gorsuch also looked to Congress's statement of purpose in the BSA. The emphasis on "reports" or "records," Justice Gorsuch concluded, shows that the relevant legal duty is the filing of required reports. Similarly, he contended that the fact the regulations permit those with more than 25 accounts to provide fewer initial details suggests that the filing of reports is the focus of the regulatory scheme, rather than "to ensure the presentation of every detail or to maximize revenue for each mistake."

Justice Gorsuch also reasoned that the per-account interpretation could lead to anomalies in application. Individuals with low foreign account balances across several accounts would face greater potential penalties for non-willful violations than those with an extremely high balance in a single account. The less-stringent initial reporting requirement for those with more than 25 accounts could place those with fewer accounts in more jeopardy than those with a very high number of accounts. Willful violators with certain balances might face lower potential penalties than some non-willful violators.

Rule of Lenity

In the final portion of his opinion, joined only by Justice Jackson, Justice Gorsuch argued that if any doubt remained about the best reading of the BSA, the rule of lenity would favor the per-report approach. "Under the rule of lenity," he explained, the Supreme Court has held that "statutes imposing penalties are to be 'construed strictly' against the government and in favor of individuals." The IRS argued that precedent applying the rule of lenity in the Internal Revenue Code should not apply in the BSA, but Justice Gorsuch disagreed and noted applications of the rule to a variety of civil penalty provisions.

Justice Gorsuch reasoned that application of the rule of lenity was particularly appropriate in *Bittner* because of fair-notice concerns and potential criminal ramifications. First, confusion among experienced tax professionals and the government's guidance documents suggested a fair-notice problem, raising due process concerns. Second, 18 U.S.C. § 5322 provides criminal sanctions for willfully violating the BSA, so a broad construction of "violations" in Section 5321 could produce large criminal penalties under Section 5322.

Dissent

The dissenting Justices would have adopted the per-account interpretation as the most natural reading of the BSA. Justice Barrett argued that Section 5314 conditions reporting requirements on the maintenance of "a relation" with a foreign financial agency, such as an account. Furthermore, she contended, Section 5314's requirements for detailed reporting of any relationship and the maintenance of records are best understood in terms of specific accounts.

Justice Barrett understands Section 5321 to show that Congress treated a "violation" as account-specific throughout the section, establishing a pattern that extends to the non-willful penalty provision because identical words used in different parts of the same statute are generally presumed to have the same meaning. She argued that the *expressio unius* canon is inapplicable where, as here, context suggests otherwise. In the dissenters' view, Congress explicitly referenced "accounts" in the reasonable cause exception and the willful penalty provision only because it was conditioning something on the balance of an account. Congress did not use "account" in the non-willful penalty provision because there was no such condition, not because it was varying the understanding of a violation.

According to the dissent, the majority wrongly conflated the "reports" required by Section 5314 with the FBAR form. Justice Barrett argued that the implementing regulations make this distinction between account-based reports and the procedural mechanism of the FBAR form. She also critiqued the majority's citation of guidance documents, reading of the BSA's purpose, and understanding of the regulatory treatment of persons with more than 25 accounts. Justice Barrett characterized the majority's discussion of potentially absurd results that might flow from a per-account interpretation as ranging "from the overstated to the incorrect," and "in any event of limited relevance to the statutory interpretation question" before the Court.

Finally, Justice Barrett noted that while Bittner faced a substantial penalty under the per-account interpretation, the BSA offers the reasonable cause exception as a safe haven. Bittner argued for the application of that exception before the lower courts, but those courts concluded that Bittner did not exercise ordinary business care and prudence in ascertaining the reporting obligations for his complex business interests. Bittner did not seek review of those conclusions in the Supreme Court.

Considerations for Congress

The *Bittner* opinions reflect the close resolution of a difficult question of statutory interpretation. The result, while divided, resolves the circuit split and establishes the per-report approach as the governing interpretation of the penalty for non-willful violations of the BSA's foreign account reporting requirements.

Other questions concerning FBAR-related penalties may be raised. In a footnote, Justice Gorsuch noted that the question of "[w]hat, if any, *mens rea* the government must prove to impose a 'non-willful' penalty" was not before the Supreme Court. In another case, a petitioner has asked the Court to address how "willfullness" should be determined for alleged willful violations. In *Bittner*, the government argued that the annual FBAR form is a creature of regulation and that the broad language of Section 5314 would permit it to adopt alternative reporting requirements with greater frequency or account specificity requirements. Any such efforts may raise new legal questions.

If Congress prefers that non-willful penalties be subject to a per-account maximum, it could amend the BSA to specify that approach. It could also consider broader amendments to the civil penalty provisions for foreign account reporting violations or revisions to the reporting requirements themselves to resolve some of the other interpretive disputes outlined above. Considerations in any such effort would include the criminal, tax, and national security goals of the BSA along with the regulatory burdens imposed on

those required to file reports. Congress could also do nothing, accepting the prevailing interpretation of its statutory language.

Author Information

Alexander H. Pepper
Legislative Attorney

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