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The Excessive Fines Clause Comes for the FBAR Civil Penalty

By Jeremy H. Temkin
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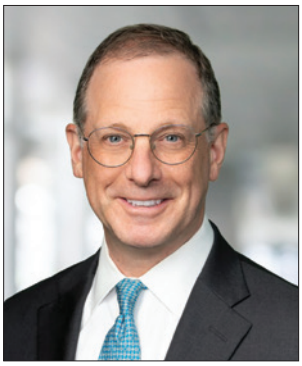
Congress has long required taxpayers with interests in certain foreign bank accounts to report their holdings on Reports of Foreign Bank and Financial Accounts, commonly known as FBARs. As this column has previously discussed, willfully failing to report accounts exposes taxpayers to penalties of up to $100,000, or 50% of the balance of unreported accounts, while a lesser penalty of $10,000 applies to non-willful violations. See Jeremy H. Temkin, "Civil FBAR Penalty Litigation: No Reprieve for Taxpayers," N.Y.L.J. (Mar. 18, 2021) (willful violations); Jeremy H. Temkin, "US Supreme Court Gives Taxpayers an FBAR Win," N.Y.L.J. (Mar. 16, 2023) (non-willful violations).

But long before Congress adopted this penalty structure, the Eighth Amendment to the Constitution prohibited the federal government from imposing "excessive fines." U.S. Const. Am. VIII. The Supreme Court has interpreted this provision to cover both criminal and civil monetary sanctions, if those sanctions are intended, at least in part, as "punishment." *Austin v. United States*, 509 U.S. 602, 610 (1993). On Aug. 30, 2024, a panel of the U.S. Court of Appeals for the Eleventh Circuit ruled that the penalty for willfully failing to file an FBAR qualifies as a "fine" under the Eighth Amendment, and that the penalties imposed in the case were, in part, unconstitutionally excessive. *United States v. Schwarzbaum*, ___ F. 4th ___, No. 22-14058, 2024 WL 3997326, at *17 (Aug. 30, 2024). The Eleventh Circuit's decision in *Schwarzbaum* diverged from the First Circuit's conclusion in *United States v. Toth*, 33 F.4th 1 (2022), and is the first case to hold that willful FBAR penalties are subject to the limitations of the Eighth Amendment. This column addresses the Circuit split established by *Schwarzbaum* and *Toth*.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'Toth': The First Circuit Rejects a Taxpayer's Excessive Fines Argument

In *United States v. Toth*, the U.S. Court of Appeals for the First Circuit rejected a taxpayer's argument that application of the maximum 50% FBAR penalty, amounting to more than $2 million, was an unconstitutionally excessive fine. The taxpayer in *Toth* had held a Swiss bank account for several years, but only began filing FBARs in 2010. The IRS contended that Toth's failure to file an FBAR in 2007 was willful and imposed the maximum penalty for that year. Toth refused to pay the penalty, and the IRS sued to collect. In the district court, Toth initially elected to proceed pro se, with disastrous consequences. Even after the court granted her motion to set aside a default judgment, Toth missed several

discovery deadlines, and even deadlines for opposing the government's motion for discovery sanctions. As a discovery sanction, the district court concluded that Toth's violation of her FBAR obligations had been willful. After hiring counsel, Toth unsuccessfully raised the excessive fines argument in opposition to the government's motion for summary judgment.

On appeal, the First Circuit affirmed. The panel distinguished Supreme Court cases that applied the Excessive Fines Clause to civil forfeitures imposed at the conclusion of a criminal case, and analogized the FBAR penalties to early customs forfeiture cases that permitted monetary forfeiture for the failure to pay customs duties. The panel reasoned that where the failure to report foreign accounts resulted in a loss to the government, the FBAR penalties were remedial. Notably, the First Circuit did not address whether the FBAR penalties could have both punitive and non-punitive purposes, relied on Circuit precedent holding that the applicability of incremental penalties for willful conduct did not render a penalty punitive for purposes of the Excessive Fines Clause, and found that the existence of a tiered penalty scheme does not, in and of itself, suggest that a penalty is a punishment.

Toth filed a petition for a writ of certiorari and her case caught the attention of Justice Neil Gorsuch who dissented from the denial of the petition, noting that "[e]ven supposing, however, that Ms. Toth's penalty bore both punitive and compensatory purposes, it would still merit constitutional review. Under our cases a fine that serves even 'in part to punish' is subject to analysis under the Excessive Fines Clause." *Toth v. United States*, 598 U.S. ___, 143 S. Ct. 552 (2023) (quoting *Austin*, 509 U.S. at 610) (Gorsuch, J., dissenting from denial of certiorari).

'Schwarzbaum': The Eleventh Circuit Applies the Excessive Fines Clause

Two years later, the Eleventh Circuit reached the opposite result in *Schwarzbaum*. Isac Schwarzbaum is the son of a wealthy German textile and real estate entrepreneur who lived in Germany, Spain, Costa Rica, Switzerland and the U.S., where he became a naturalized citizen. From 2001 until his death in 2009, Schwarzbaum's father transferred Swiss bank accounts into his son's name, and Schwarzbaum himself opened bank additional accounts in other countries that he lived in. Between 2006 and 2009, Schwarzbaum had millions of dollars in numerous undisclosed Swiss and Costa Rican bank accounts. In several years, Schwarzbaum hired CPAs to prepare his tax returns and FBARs, but the CPAs failed to disclose all of his accounts and in some years failed to file FBARs at all. Schwarzbaum later opted to prepare his tax returns himself but repeated the CPAs' mistakes by either failing to file FBARs or failing to include all of his foreign accounts on the forms he did file.

In 2010, Schwarzbaum participated in the IRS's Offshore Voluntary Disclosure Initiative, and reported 17 Swiss and four Costa Rican bank accounts that he held from 2003 to 2010. Schwarzbaum later opted out of the disclosure initiative. Following an examination, the IRS determined that Schwarzbaum's failure to file FBARs for 2006-2009 had been willful, and sought the maximum penalty for each account, a total of almost $13.8 million. Schwarzbaum refused to pay, and the IRS brought a civil action to collect. The district court found that Schwarzbaum's failure to file FBARs was reckless, which served as a predicate for the heightened penalties applicable to willful conduct. After other litigation not relevant here and an initial trip to the Eleventh Circuit, the penalty was reduced to $12.6 million. The district court rejected Schwarzbaum's argument that this amount was unconstitutionally excessive, and Schwarzbaum appealed to the Eleventh Circuit.

In holding that the FBAR penalties were unconstitutionally excessive fines, Judge Stanley Marcus, writing for a unanimous panel that included Judges Adalberto Jordan and Barbara Lagoa, reviewed the history of the Excessive Fines Clause before addressing the critical questions of whether the fines constituted "punishment," and whether that punishment was excessive. In defending the penalty imposed, the government argued that the limitations of

the Excessive Fines Clause did not apply to civil FBAR penalties because the purpose of those penalties was not punishment but rather to reimburse the government for its investigation and enforcement expenses. The court rejected this argument because the penalties at issue bore no relation to the actual investigation and enforcement expenses, especially in this case, as Schwarzbaum had self-disclosed the existence of his accounts. The panel also found that the design of the statute, providing for lesser penalties for non-willful violations combined with heightened penalties where the government establishes the defendant acted with culpable mens rea, demonstrated that the willful FBAR penalties were designed to be punitive. The court bolstered its conclusion by noting that the term "willfulness" appears in both the civil and criminal penalty provisions of the FBAR statute, and that Congress and the IRS had both described the FBAR penalties as promoting deterrence.

In reaching this result, the Eleventh Circuit noted that *Toth* had improperly relied on cases applying the Double Jeopardy Clause, finding that later Supreme Court precedent had altered the relevant standard in the Excessive Fines context. While a penalty does not need to be "solely remedial" to avoid violating the Double Jeopardy Clause, the same is not true for the Excessive Fines Clause, which will apply to a financial sanction even if it is only partially intended to punish misconduct. The *Schwarzbaum* panel also noted that the *Toth* court did not grapple with the question of mixed purpose fines, and that differing circuit precedent also may have contributed to the differing results.

A Hollow Victory?

After finding that the Excessive Fines Clause applies to the FBAR penalty, the Eleventh Circuit panel noted that Schwarzbaum did not bring a facial challenge to the FBAR penalty regime, and thus it did not consider whether a 50% fine, in the abstract, would be unconstitutionally excessive. Rather, beginning its analysis with a "strong presumption" that the Congress' chosen regime was constitutional, *Schwarzbaum*, 2024 WL 3997326 at *12, the court rejected Schwarzbaum's argument that the analysis should focus on the total penalty assessed, and proceeded to review the penalties on an account-by-account basis. Under this approach, the court cut a mere $300,000 from Schwarzbaum's $12.6 million penalty finding that imposition of three separate $100,000 penalties for an account that had never held more than $16,000, was unconstitutionally disproportionate.

The court, however, upheld other, much larger penalties—including one for more than $4 million for a single account in one year. For many accounts, the IRS was able to determine the high balance for the preceding year, but did not know the balance on the date the FBAR was due. In those instances, it had assessed the fixed $100,000 penalty. Given that the lowest known high balance in those accounts was more than $670,000 and the highest such balance was more than $8 million, the court found this approach did not result in the imposition of an excessive fine.

The Implications of 'Schwarzbaum'

Schwarzbaum is the first Circuit Court of Appeals to conclude that an FBAR penalty was unconstitutionally excessive. Its reasoning is much stronger than that of *Toth*, in that it grapples directly with modern Eighth Amendment doctrine that recognizes that a penalty can be partially punitive and partially remedial, recognizes that the size of willful FBAR penalties are unconnected to the lost revenues attributable to the taxpayer's conduct, and deals with the invocation of a willfulness mens rea requirement. Combined with Justice Gorsuch's prior expression of concern with the issue, the Circuit split increases the likelihood the Supreme Court will step in to resolve the question.

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