Current Federal Tax Developments

Week of November 11, 2019

Edward K. Zollars, CPA
(Licensed in Arizona)

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SECTION: FBAR REPORTING
2004 LAW CHANGE INVALIDATED TREASURY REGULATION SETTING CAP AT $100,000 FOR PENALTY TO WILLFULLY FILE FBAR, OVER $800,000 IN PENALTIES IMPOSED

Citation: Norman v. United States, CA Federal Circuit, Case No. 18-2408, 11/8/19

In 2018 we discussed two U.S. District Court cases where the IRS's attempt to impose a greater than $100,000 penalty for willful failure to file a Foreign Bank Account Report (FBAR) return was denied by the courts, finding that a Treasury regulation that had not been changed since Congress removed the $100,000 maximum on such willful failures still controlled.[1] The issue has now been addressed for the first time by a U.S. Circuit Court of Appeals in the case of *Norman v. United States*[2] and the IRS is much happier with the result.

31 USC §5321(a)(5), prior to amendment by Congress in 2004, provided that the maximum penalty for willful failure to file an FBAR return was limited to:

- The amount in the account at the time of the violation (not to exceed $100,000) *or*
- $25,000.

In 2004, Congress revised the law, setting the maximum penalty at the greater of

- $100,000 or

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[1] See Ed Zollars, "Penalty Limited to Maximum Amount Stated in Regulation Not Updated for Later Increase in Maximum Penalty," *Current Federal Tax Developments* website, May, 22, 2018, https://www.currentfederaltaxdevelopments.com/blog/2018/5/22/penalty-limited-to-maximum-amount-stated-in-regulation-not-updated-for-later-increase-in-maximum-penalty and Ed Zollars, "Another District Court Agrees Maximum FBAR Penalty Limited to $100,000," *Current Federal Tax Developments* website, July 21, 2018, https://www.currentfederaltaxdevelopments.com/blog/2018/7/21/another-district-court-agrees-maximum-fbar-penalty-limited-to-100000, retrieved November 9, 2019

[2] *Norman v. United States*, CA Federal Circuit, Case No. 18-2408, November 8, 2019, http://www.cafc.uscourts.gov/sites/default/files/opinions-orders/18-2408.Opinion.11-8-2019.pdf, retrieved November 8, 2019.

- 50% of the amount in the account.[3]

However, the Treasury has never updated its regulations to reflect the revised maximum. So the regulations still provided the largest penalty that could be imposed was $100,000. Taxpayers had won in certain cases the right to limit their penalty to $100,000 by arguing that Congress only set a maximum penalty, so Treasury could set a lower maximum by regulation. Having not changed the regulation, the Treasury had implicitly decided to continue to limit the maximum penalty to $100,000—or, so the taxpayers argued.

In this case, Ms. Norman, a schoolteacher, had an offshore account that, between 2001 and 2008, had from $1.5 million to $2.5 million in it. She had a numbered account with UBS which meant the account did not list her name, but only had an account number to identify it. She was actively engaged with UBS regarding the management of this account, and frequently spoke with her UBS representative by phone during this time.[4]

The panel notes that when UBS decided to change its approach following pressure from the U.S. government, Ms. Norman was not happy:

> UBS client contact records indicate that in April 2008, Ms. Norman expressed surprise and displeasure when she was informed of UBS's "new business model,"2 which the Court of Federal Claims found referred to UBS's business decision to "no longer provide offshore banking" and to work "with the US Government to identify the names of US clients who may have engaged in tax fraud." See *Norman*, 138 Fed. Cl. at 194 (quoting statement by UBS representative Mark Branson while testifying at a Senate Subcommittee hearing). Just before UBS publicly announced this new business plan in July 2008, Ms. Norman closed her account with UBS and transferred her funds to another foreign bank.[5]

It seems one reason Ms. Norman may have been upset about this change of heart by UBS was that she had some issues with FBAR filings. As the opinion notes:

> Ms. Norman did not file a timely FBAR disclosing the existence of her UBS account in any year, including in 2007, which is the tax year at issue in this case. In addition, Ms. Norman signed, under penalty of perjury, her 2007 tax return, which falsely indicated that she had no interest in any foreign bank account. She signed her tax return after

[3] 31 USC §5321(a)(5)(C)

[4] *Norman v. United States*, p. 2

[5] *Norman v. United States*, p. 3

> her accountant sent her a questionnaire specifically inquiring whether she had an interest in any foreign bank accounts.[6]

This turn of events at UBS caused Ms. Norman to take action to report her accounts—but ultimately her actions did not work out well for her.

> In 2008, Ms. Norman was referred to an accountant who filed amended tax returns and late FBARs. The IRS subsequently opened an audit of Ms. Norman. During this audit, Ms. Norman made numerous false statements to the IRS. For instance, Ms. Norman told the IRS, both during an interview and in a letter, that she first learned of her foreign account in 2009. In the letter, she further stated that she "was shocked to first hear about the existence of foreign accounts" in her name. J.A. 133. After retaining counsel, Ms. Norman sent the IRS a second letter "to correct several misstatements." J.A. 145–47. In this letter, she admitted that she had known for over a decade that she had an "interest" in a foreign bank account, but still stated that "none of the money in the account(s) was mine[,] and I did not consider myself to have any kind of control over the account." J.A. 146.[7]

The IRS ultimately assessed a penalty of $803,530 against Ms. Norman for willfully failing to report this account. The taxpayer filed an action in the Court of Federal Claims contesting this penalty, specifically indicating that since the regulation capped the penalty for willful violations at $100,000 her penalty should be at least reduced to $100,000. The trial court did not agree with her view, and upheld the IRS's entire penalty. She then appealed the case to the Court of Appeals for the Federal Circuit.

She did attempt to argue that her conduct should not have been found to be willful and, as you might guess from the facts, not surprisingly the appellate panel did not accept that view. One paragraph is of particular note, since the Court did not accept her attempt at a defense claiming that she didn't read the 2007 return before signing. The opinion holds:

> Ms. Norman also argues that she could not have willfully violated the FBAR requirement because she did not read her 2007 tax return. But whether Ms. Norman ever read her 2007 tax return is of no import because "[a] taxpayer who signs a tax return will not be heard to claim innocence for not having actually read the return, as he or she is charged with constructive knowledge of its contents." *Greer v. Comm'r of Internal Revenue*, 595 F.3d 338, 347 n.4 (6th Cir. 2010); see also *United States v. Doherty*, 233 F.3d 1275, 1282 n.10 (11th Cir. 2000) (finding that taxpayer "signed the fraudulent tax form and may be

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[6] *Norman v. United States*, p. 4

[7] *Norman v. United States*, p. 4

> charged with knowledge of its contents"). The fact that Ms. Norman did not read her 2007 tax return supports that she acted recklessly toward the existence of reporting requirements.[8]

The panel also did not accept the argument that the IRS was bound by the unchanged regulation. The panel found that the change of the law by Congress in 2004 invalidated the regulation:

> The plain language of the statute, as amended in 2004, indicates that, for willful FBAR violations, "the maximum penalty . . . shall be increased to the greater of" $100,000 or fifty percent of the balance in the account at the time of the violation. 31 U.S.C. § 5321(a)(5)(A)–(D) (emphasis added). The use of the word "shall" means what follows is mandatory, not discretionary. See, e.g., Hyatt v. U.S. Patent & Trademark Office, 797 F.3d 1374, 1380 (Fed. Cir. 2015). Accordingly, Congress set a maximum penalty that must govern whenever the IRS imposes a willful FBAR penalty.
>
> Because the 1987 regulation sets forth a maximum willful FBAR penalty that is inconsistent with the maximum penalty mandated by statute, the 1987 regulation is no longer valid. See, e.g., *R&W Flammann GmbH v. United States*, 339 F.3d 1320, 1324 (Fed. Cir. 2003); *Barseback Kraft AB v. United States*, 121 F.3d 1475, 1480 (Fed. Cir. 1997); *Aerolineas Argentinas v. United States*, 77 F.3d 1564, 1575 (Fed. Cir. 1996); see also *Farrell v. United States*, 313 F.3d 1214, 1219 (9th Cir. 2002).[9]

The panel went on to hold that Treasury lacks the authority to set a different maximum penalty by regulation:

> But the language relied upon by Ms. Norman — that the Secretary "may" impose a penalty — merely gives the Secretary discretion as to whether to impose a penalty in any particular case. This language does not mean that the Secretary has the authority to set a penalty cap on all cases that is different than the penalty cap Congress mandated.
>
> …
>
> Ms. Norman further contends that the 1987 regulation constitutes an interpretation of 31 U.S.C. § 5321 that warrants *Chevron* deference. But even if the 1987 regulation constitutes an interpretation of 31 U.S.C. § 5321, the 1987 regulation is not entitled to Chevron

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[8] *Norman v. United States*, pp. 8-9

[9] *Norman v. United States*, p. 10

> deference. Because the statute is unambiguous, we "must give effect to the unambiguously expressed intent of Congress." *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842–43 (1984). [10]

In addition to getting a detailed analysis of the argument regarding whether Treasury's failure to update the regulation takes the teeth out of the 2004 law change in this area from the first appellate court to consider the issue, this case provides some other lessons for taxpayers and advisers.

First, when a taxpayer decides to "come clean" with the IRS because he/she is afraid he/she is about to be discovered, attempts to disclose only what you think the IRS will discover to continue what deception you think might still be possible tends not to turn out well.

Second, note that this case is yet another where the IRS was able to successfully use the questions on Schedule B to prove willful failure to file an FBAR form. Taxpayers and advisers should expect the IRS will treat the question regarding virtual currency transactions added to Schedule 1 of Form 1040 for 2019 in a similar fashion—taxpayers who affirmatively claim to have no such transactions may find the IRS similarly using the question to show a willful intent to avoid reporting such income.

Remember, as well, that it is no defense for a taxpayer to claim he/she did not read the return before filing—even if many clients seem to feel they have no need to take that step. Clients should be reminded that, legally, the return is theirs and if there is anything that, given their skill and experience, they *should have noticed was in error on the return*, they will be held responsible for the error on the return by the IRS and courts when it comes to penalties.

SECTION: 1
INFLATION ADJUSTED NUMBERS FOR 2020 ISSUED BY IRS

Citation: Revenue Procedure 2019-44, 11/6/19

The IRS published various cost of living adjusted numbers for the 2020 tax year in Revenue Procedure 2019-44.[11]

This procedure, published annually, deals with most items that are to be inflation adjusted by law aside from items related to retirement plans and health savings accounts, for which other revenue procedures are published each year. In fact, the

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[10] *Norman v. United States*, pp. 10-11

[11] Revenue Procedure 2019-44, November 6, 2019, https://www.irs.gov/pub/irs-drop/rp-19-44.pdf, retrieved November 9, 2019

retirement plan numbers were published on the same day as this main procedure this year.

Some key numbers in the procedure are:

- Tax rate schedules for individuals (all filing statuses) and trusts/estates;
- Standard deduction for all filing statuses;
- §179 items: Maximum amount that can be expensed will be $1,040,000, while the amount will begin to be phased out when total additions for the year exceed $2,590,000;
- Threshold amounts for the qualified business income deduction under §199A will be $326,600 for married couples filing a joint return and $163,300 for all other filing statuses;
- Maximum average revenue for use of the cash method of accounting will be $26,000,000;
- The threshold for excess business losses will be $259,000 ($518,000 for married couples filing a joint return);
- The basic exclusion amount for decedents dying in 2020 will be $11,580,000; and
- The annual exclusion for present interest gifts will be $15,000.

The other numbers are found in the Revenue Procedure available at the link provided in the footnotes.

SECTION: 409
IRS ISSUES PROPOSED REVISIONS TO FACTORS USED TO COMPUTED REQUIRED MINIMUM DISTRIBUTIONS

Citation: REG-132210-18, 11/7/19

In response to an Executive Order issued on August 31, 2018,[12] the IRS has now released proposed regulations updating the life expectancy tables to be used in

[12] Executive Order 13847, 83 FR 45321, August 31, 2018

computing required minimum distributions from retirement plans.[13] The new tables are proposed to be used beginning in 2021.

The preamble to the proposed regulations describes the change to the IRS regulations as follows:

> Executive Order 13847, 83 FR 45321, which was signed on August 31, 2018, directs the Secretary of the Treasury to examine the life expectancy and distribution period tables in the regulations on required minimum distributions from retirement plans and determine whether they should be updated to reflect current mortality data and whether such updates should be made annually or on another periodic basis. The purpose of any such updates would be to increase the effectiveness of tax-favored retirement programs by allowing retirees to retain sufficient retirement savings in these programs for their later years.[14]

The preamble goes on to summarize the results of the change as follows:

> The life expectancy tables and applicable distribution period tables in the proposed regulations reflect longer life expectancies than the tables in the existing Table to calculate required minimum distributions must use a life expectancy of 27.4 years under the existing regulations. Using the Uniform Lifetime Table set forth in the proposed regulations, this IRA owner would use a life expectancy of 29.1 years to calculate required minimum distributions. As another example, under the existing regulations, a 75-year old surviving spouse who is the employee's sole beneficiary and uses the Single Life Table to compute required minimum distributions must use a life expectancy of 13.4 years. Under the proposed regulations, the spouse would use a life expectancy of 14.8 years. The effect of these changes is to reduce required minimum distributions, which will allow participants to retain larger amounts in their retirement plans to account for the possibility they may live longer.[15]

The proposed effective date is described as follows in the preamble:

> The life expectancy tables and Uniform Lifetime Table under these proposed regulations would apply for distribution calendar years

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[13] REG-132210-18, November 7, 2019, https://www.govinfo.gov/content/pkg/FR-2019-11-08/pdf/2019-24065.pdf, retrieved November 9, 2019

[14] REG-132210-18, p. 9

[15] REG-132210-18, pp. 9-10

> beginning on or after January 1, 2021. Thus, for example, for an individual who attains age 70½ during 2020 (so that the minimum required distribution for the distribution calendar year 2020 is due April 1, 2021), the final regulations would not apply to the minimum required distribution for the individual's 2020 distribution calendar year (which is due April 1, 2021), but would apply to the minimum required distribution for the individual's 2021 distribution calendar year (which is due December 31, 2021).[16]

The revised table that affects the most taxpayers is the Uniform Lifetime Table, used most often to compute required minimum distributions for the original beneficiary for IRA accounts and qualified plan accounts. The IRS describes the use of this table as follows:

> The Uniform Lifetime Table in the proposed regulations sets forth joint and last survivor life expectancies for each age beginning with age 70, based on a hypothetical beneficiary. Pursuant to §1.401(a)(9)-5, Q&A-4(a), the Uniform Lifetime Table is used for determining the distribution period for lifetime distributions to an employee in situations in which the employee's surviving spouse either is not the sole designated beneficiary or is the sole designated beneficiary but is not more than 10 years younger than the employee. As under the existing regulations, the joint and last survivor life expectancy of an employee is taken from the Joint and Last Survivor Table using a hypothetical beneficiary who is assumed to be 10 years younger than the employee.[17]

The proposed Uniform Life Table is reproduced below:[18]

Age of Employee	Distribution Period
70	29.1
71	28.2
72	27.3

[16] REG-132210-18, p. 12

[17] REG-132210-18, p. 11

[18] Proposed Reg. §1.409(a)(9)-9(c)

Age of Employee	Distribution Period
73	26.4
74	25.5
75	24.6
76	23.7
77	22.8
78	21.9
79	21.0
80	20.2
81	19.3
82	18.4
83	17.6
84	16.8
85	16.0
86	15.2
87	14.4

Age of Employee	Distribution Period
88	13.6
89	12.9
90	12.1
91	11.4
92	10.8
93	10.1
94	9.5
95	8.9
96	8.3
97	7.8
98	7.3
99	6.8
100	6.4
101	5.9
102	5.6

Age of Employee	Distribution Period
103	5.2
104	4.9
105	4.6
106	4.3
107	4.1
108	3.9
109	3.7
110	3.5
111	3.4
112	3.2
113	3.1
114	3.0
115	2.9
116	2.8

The other tables, which are used less frequently, can be found in the text of the proposed regulations.

SECTION: 415
ANNUAL INFLATION ADJUSTMENTS FOR RETIRMENT PLANS ANNOUNCED

Citation: Notice 2019-59, 11/6/19

The IRS has released the 2020 inflation adjusted limits for qualified retirement plans and IRAs in Notice 2019-59.[19]

The revised numbers and prior 2019 amounts are provided in the table below:

Type	2020 Amounts	2019 Amounts
Maximum annual benefit-DB Plan (§415)	$ 230,000	$ 225,000
Contribution limit DC Plan (§415)	57,000	56,000
Annual Compensation Limit (§404(l))	285,000	280,000
Catch up Contributions to Employer Plan	6,500	6,000
Elective Deferrals (§402(g))	19,500	19,000
Highly Compensated Employee (§414(q))	130,000	125,000
Key Employee Compensation (§416(i))	185,000	180,000
SIMPLE Deferral Limitation (§408(p))	13,500	13,000
SIMPLE Catch Up Contribution (414(v)(2)(B))	3,000	3,000
SEP Compensation Limit (§408(k))	600	600
IRA Limitations		

[19] Notice 2019-59, November 6, 2019, retrieved November 6, 2019

Type	2020 Amounts	2019 Amounts
Maximum IRA Contribution (before catch-up) (§219(b)(5)(A))	6,000	6,000
Deduction phases out for individuals that are an active participant in an employer plan for adjusted gross income between	Single and Head of Household - $65,000 to $75,000	Single and Head of Household - $64,000 to $74,000
	Married Filing Joint - $104,000 - $124,000	Married Filing Joint - $103,000 - $123,000
	Married Filing Separate - $0 - $10,000	Married Filing Separate - $0 - $10,000
Deduction phases out for individuals whose spouse is an active participant in an employer plan phases out between	$196,000 - $206,000	$193,000 - $203,000
Roth IRA Maximum Contribution Phaseout Begins:		
Married filing joint	196,000	193,000
Other except married filing separate	124,000	122,000

The IRS normally publishes this update each year around the end of October or the beginning of November.