Current Federal Tax Developments

Week of June 8, 2021

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ACCOUNTING
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SECTION: FBAR REPORTING
IGNORANCE WAS NOT BLISS: CPA FOUND LIABLE FOR OVER $663,000 OF FBAR PENALTIES FOR ACCOUNTS HE FAILED TO REPORT

Citation: United States v. Kronowitz, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, 6/3/21

A CPA with 60 years of experience in preparing tax returns found that the Court wasn't very sympathetic regarding his failure to file FBAR reports, even though income had been (kind of) reported in the case of *United States v. Kronowitz*.[1]

Taxpayer's Background as a CPA

The taxpayer in this case was a CPA who had a small practice that consisted mainly of individuals and small local businesses.[2] His practice was described as follows:

> Kronowitz was a professional tax preparer and has been preparing tax returns since 1961 or 1962. For the majority of his career, he prepared between thirty (30) and forty (40) tax returns per year. He began to wind down his practice in 2008 because of his declining health. Nevertheless, as recently as 2020, he was preparing tax returns for others for money. Indeed, for tax years 2019 and 2020, he prepared approximately ten (10) to fifteen (15) federal income tax returns each year. In his tax preparation practice, he prepared 1040s (personal returns) and 1120s (corporate returns) for subchapter S corporations. He also prepared his own tax returns.[3]

The Court noted that Mr. Kronowitz had been required to regularly attend continuing professional education courses:

> In order to maintain his CPA certification, he was required to participate every two years in eighty (80) hours of continuing professional education ("CPE"). During the course of his career, he took CPE courses such as Tax Shelter Seminar, Foreign Taxation, Offshore Trusts, and Asset Protection/Est[ate] Pl[an]ning. He does not recall the FBAR being specifically mentioned in any CPE class.[4]

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[1] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/longtime-cpa-is-liable-for-willful-fbar-penalties/76khr (retrieved June 4, 2021)

[2] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[3] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[4] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

Offshore Accounts

Mr. Kronowitz's offshore adventures began when a client allowed the CPA to invest in a portion of certain projects in different countries:

> Eli Levy, a real estate developer, was a client of Kronowitz's beginning in the 1970s. Kronowitz did Levy's Florida business returns but did not handle his personal returns or anything in other countries. However, Levy did give Kronowitz the opportunity to buy one or two percent of a couple of projects in different countries as a reward for good service. Kronowitz knew he was investing in properties in different countries.[5]

Mr. Kronowitz did not ask a lot of questions about the investments he made with Mr. Levy:

> Kronowitz invested with Levy mostly in the 1970s. He would meet with Levy in person and give him a check for the investment. In return, Levy did not give him any statement or confirmation of the investment because the documents were in foreign languages. In addition, according to Kronowitz, Levy told him that if he thought Levy was trying to "screw" him, then he should not invest with Levy. Nevertheless, Kronowitz invested with Levy because he had a good feeling about Levy. Kronowitz never signed anything for Levy (other than the checks he gave Levy). Kronowitz's only record of his investments with Levy was a yellow legal pad on which he kept notes on the basis of the investments. Kronowitz does not have the yellow legal pad anymore.[6]

As well, in 1999 Mr. Kronowitz became involved with a number of foreign entities which he believes may have been established via information he had given to Mr. Levy:

> In 1999, Kronowitz's signature and former office address appeared on a document titled "Management and Administration Agreement," (the "Agreement"), ECF No. [48-8], regarding the management of an entity called Cramo Stiftung/Foundation ("Cramo"). The Agreement is between Kronowitz and an entity named Consista Treuunternehmen ("Consista"), a company in Liechtenstein, and empowers Consista to manage Cramo on behalf of Kronowitz. The Agreement is also signed by an individual named Beat Kranz, on behalf of Consista, and as director of Cramo. Kronowitz is designated as the beneficial owner of Cramo's assets, and if he is deceased, his wife is the secondary beneficiary. Kronowitz testified that he does not know what Cramo Stiftung or Cramo Foundation is, and he never met Beat Kranz. Kronowitz testified that he may have spoken to Kranz once or twice on a phone call. Kronowitz gave his personal information to Levy, including his wife and children's names and birth dates, and believes that Levy must have given that information to Consista. Although

[5] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[6] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

> Kronowitz does not remember signing any documents for Levy or for Consista, his signature appears on the Agreement. ECF No. [48-8] at 3.
>
> On October 10, 2005, Cramo opened an account at United Bank of Switzerland ("UBS"), for which Kronowitz was listed as the beneficial owner on the account opening paperwork. Kronowitz was the beneficiary of the account held at UBS by Cramo from 2005 to 2009.[7]

Asset Protection and Offshore Accounts and Trusts

In addition to these investments, Mr. Kronowitz looked to utilize offshore accounts and trust for asset protection. As the opinion noted, one of the things he did remember being discussed at CPE courses was asset protection and the advantages of having assets offshore:

> He does recall attending a course given by a University of Miami lecturer during which the movement of assets offshore for protection of those assets was discussed. …
>
> Based upon Kronowitz's attendance at the CPE course in which he remembers being advised that professionals should move assets offshore for protection, and a rumor that a former client, Irwin Mogerman, was going to sue him for fraud related to his work for Mogerman's company Grand Prix Race-o-Rama, Kronowitz opened two bank accounts in the Cayman Islands in 2001 ("Cayman Accounts"). Kronowitz had signature authority and was the financial beneficiary of the Cayman Accounts. His purpose in opening the Cayman Accounts was to keep funds out of reach from potential creditors[8]

Dealing with the Gains from the Levy Investments

Mr. Kronowitz had significant gains from the Levy investments, so he also established a trust and reported gain on the trust tax returns:

> By 2008, Kronowitz's investments with Levy had generated significant gains. In order to protect and manage the gains, Kronowitz created the 1210 Trust ("Trust"). In 2008, someone associated with Levy contacted Kronowitz and told him to contact Consista to direct where Kronowitz wanted the proceeds from his investments with Levy sent. In response, Kronowitz contacted Consista and instructed them to send the proceeds to one of his Cayman Accounts. He called the Caymans bank to verify that the wire transfers from Consista were completed. The Trust's assets in its bank account were comprised solely of transfers from Kronowitz's Cayman Accounts. Nevertheless, the Trust did not own the Cayman Accounts. Kronowitz used the

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[7] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[8] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

> information on the yellow legal pad to report the gains from his investments with Levy on his Trust's tax returns.
>
> On March 27, 2009, the funds held by Cramo at UBS were transferred to an account at Basler Kantonalbank ("BKB"), which was opened for Kronowitz's benefit. Kronowitz was identified as the beneficial owner of the account. All correspondence from the BKB account were directed to Consista.
>
> On August 11, 2009, Kronowitz sent correspondence to an individual with initials "R.Z." and directed R.Z. to transfer $300,000.00 "to my account. You have the information on file." ECF No. [41] at 14, ¶ 56; see also ECF No. [48-9].
>
> Finally, on December 6, 2010, Kronowitz e-mailed Consista and instructed them to "liquidate my account and forward all moneys as you did before to my account in the [C]aymans." Id. ¶ 57. On December 29, 2010, Cramo wired $318,067.53 to the Cayman Accounts.[9]

Dealing With Those Pesky FBAR Questions on Tax Returns

Mr. Kronowitz did report various items of income from the offshore investments on various tax returns—but answered any questions regarding the existence of offshore accounts with a "No."

> Kronowitz prepared his own tax returns for tax years 2005, 2006, 2007, 2008, 2009, and 2010. Schedule B is an attachment to the individual federal income tax return (Form 1040) that is used for reporting interest and dividend income, as well as any financial interest in, or signature authority over, financial accounts located in foreign countries. See ECF No. [41] at 9, ¶ 17. Kronowitz was required to file a Schedule B in conjunction with his 2005 through 2010 individual income tax returns; however, Kronowitz did not disclose his financial interest in foreign accounts in a Schedule B or in an FBAR for his 2005 through 2010 individual tax returns. In fact, on the Schedule B form filed with his 2008 tax return, 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." Id. at 10, ¶ 21. Furthermore, there were no Schedule B forms attached to the 2005, 2006, 2009, or 2010 individual tax returns.
>
> …
>
> Kronowitz also prepared the tax returns for the Trust for tax years 2008, 2009, and 2010. He marked "no" in response to the question asking, "[a]t any time during [the] calendar year [ ], did the estate or

[9] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

> trust have an interest in or a signature or other authority over a bank, securities, or other financial account in a foreign country?" On the 2008 Trust tax return, Kronowitz disclosed $370,700.00 in gains from investments from Brazil, Panama, and Israel. On the 2009 Trust tax return, Kronowitz disclosed $281,725.00 in gains from investments in the Cayman Islands and Brazil. On the 2010 Trust tax return, Kronowitz disclosed $296,218.00 in gains from investments in foreign countries. However, beyond writing the names of certain of the Levy investments on the 2008, 2009, and 2010 Trust tax returns, Kronowitz did not otherwise disclose his interest in any foreign accounts or assets. See ECF No. [48-6].[10]

Obviously, there are some issues here with how the tax returns in question were prepared. But Mr. Kronowitz testified that he had not read the instructions for Schedule B—and that reading such instructions wasn't really a concern of his:

> Kronowitz testified that he has probably seen hundreds of Schedule Bs over the course of his career, but admitted that he probably did not read the instructions to Schedule B because he is an accountant and not an attorney. In addition, he stated that he was more concerned with taking care of his clients and providing for his family.[11]

Failure to File FBAR Returns

As was noted, Mr. Kronowitz failed to file FBAR returns, even for years where he presumably had read the question regarding offshore accounts (since he answered the questions no). The Court provided Mr. Kronowitz's explanation:

> Although required to do so, Kronowitz admits that he did not timely file FBARs for tax years 2005 through 2010. In preparing tax returns, Kronowitz was aware of the question asking about interests in foreign accounts, but he did not do any research, nor did he look up form number TDF90-22.1 (the FBAR) referenced in the returns. He testified that he had not heard of the FBAR and that he had no knowledge that he was a beneficiary of the UBS and BKB accounts, until he hired an attorney to represent him before the IRS during an audit in 2011. Kronowitz believed that if he reported the income from a foreign source on the Trust tax returns, he had complied with his tax obligations. He never asked anybody about this assumption—he thinks he heard it at a seminar or read it somewhere. He did not see a difference in reporting the income on the Trust return or on his individual return as long as the amounts were reported and the taxes paid.[12]

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[10] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[11] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[12] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

The IRS examined Mr. Kronowitz and, unfortunately for Mr. Kronowitz, the IRS agent *did* know about the FBAR requirements. In November 2017 the IRS assessed penalties for failing to file FBAR forms for 2005-2010 in the amount of $663,771.[13]

The IRS position was that Mr. Kronowitz's failure to file the FBAR returns was willful, which triggered these rather massive penalties.

Willful Failure to File the Return and Recklessness

Obviously, Mr. Kronowitz claims that his failure to file these forms was not willful—he was just ignorant of his filing responsibilities, so how could his failure be willful?

However, the Court notes that to be willful under these rules, the violation does not have to be a knowing violation if the taxpayer behaves recklessly in failing to attempt to become properly aware of the responsibility.

> The statutes and regulations at issue in this case do not define the term willful; however, the BSA identifies the applicable penalty as a "civil money penalty." 31 U.S.C. § 5321(a)(5)(A). "[W]here willfulness is a statutory condition of civil liability, we have generally taken it to cover not only knowing violations of a standard, but reckless ones as well." *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 57 (2007). "While the term recklessness is not self-defining, the common law has generally understood it in the sphere of civil liability as conduct violating an objective standard: action entailing an unjustifiably high risk of harm that is either known or so obvious that it should be known." *Id.* at 68 (quoting *Farmer v. Brennan*, 511 U.S. 825, 836, 114 S. Ct. 1970, 128 L. Ed 2d 811 (1994)) (internal quotations omitted). In the FBAR context, 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." *United States v. Rum*, --- F.3d ----, 2021 WL 1589153, at *6 (11th Cir. Apr. 23, 2021).[14]

Citing *United States v. Horowitz*, 978 F.3d 80, 89 (4th Cir. 2020) the opinion finds in this case willfulness based on recklessness is established if the taxpayer:

- Clearly ought to have known that
- There was a grave risk that an accurate FBAR was not being filed *and*
- He was in a position to find out for certain very easily.[15]

The Court found a number of factors supported the view that Mr. Kronowitz's actions were reckless with regard to his FBAR filings.

[13] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[14] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[15] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

First, the fact that he had been involved in tax practice for 60 years meant that he was not someone unaware of the tax in general—dealing with tax issues had been his primary business for his life.

The Court was also not impressed with his failure to even consult the instructions for the Schedules that he was preparing:

> He admitted to seeing hundreds of Schedule Bs, and being familiar with the purpose of Schedule B and its requirements, but testified that he probably did not read the instructions because he was more concerned with providing for his family and taking care of his clients. Indeed, he testified that "my purpose in life at the time was to get clients, bill them, and collect the money, not spending the whole year reading[.]"[16]

This author is somewhat amazed the taxpayer expected the Court to believe that someone made it through 60 years of tax practice believing that actually spending time understanding the law he was supposedly following in serving his clients was unnecessary, as well as not realizing such understanding might help in keeping his family safe from the consequences of a failure to properly apply the law (in this case, an amount that has now grown to $753,680.37 by the time the Government filed its complaint).

As well, even what he did read (the questions asking if he had such foreign accounts) he either failed entirely to understand or just intentionally decided to answer in error:

> Furthermore, Kronowitz affirmatively answered "no" to questions regarding interests in foreign accounts on both his individual tax returns and on the Trust tax returns he prepared.[17]

Not wanting to read to find out the proper treatment of items, he claims to have developed his reporting positions by "assuming" none of the details mattered:

> He simply and incorrectly assumed that reporting the gains from his Levy investments would be sufficient to satisfy tax reporting obligations. When asked why he chose to report the gains on the Trust return as opposed to reporting the gains on his personal return, he responded that
>
> > …that's where the money went, that's where the money came out to pay the taxes. Okay. From the 1210 Trust. I didn't see any big difference one way or the other. As long as they were reported and the taxes were paid.[18]

Unfortunately for the taxpayer, it turns out this did make a big difference.

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[16] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[17] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[18] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

Actions Aren't Consistent with a Simple Mistake

The Court also makes clear it doesn't really accept this is just the simple, innocent mistakes of someone who might not have been the most skilled tax researcher among CPAs. Rather, his actions suggest he remained willfully ignorant of key details (which I suspect the Court also believes explains his failure to want to spend time reading up on tax law):

> Beginning with his investments with Levy, Kronowitz displayed a surprisingly laissez-faire attitude—he simply gave Levy his money and did not ask any questions, even when he was given no receipt or acknowledgment for the funds he invested. He also failed to ask any questions about how his funds would be held for him, or how he might access them if needed. Therefore, the Court does not assign much weight to the fact that Kronowitz did not know that he was the beneficiary of two Swiss bank accounts containing the proceeds from his Levy investments. He did not know because he never asked how Levy would handle his investments or the proceeds they might potentially generate. Moreover, even when he learned that his investments had generated significant gains, he still asked no questions and simply directed the transfer of funds to his Cayman Accounts. Similarly, in reporting the gains on those investments, he simply assumed that putting them on the Trust tax return would be sufficient—he neither did any research, nor did he ask anyone with more expertise if his assumption was correct. In addition, despite preparing hundreds of tax returns and his familiarity with the forms, which contain instructions and questions pertaining specifically to interests in foreign accounts, he never inquired whether his foreign accounts might trigger any additional obligations on his part.[19]

The circuitous route funds took to get into the Trust accounts additionally caught the attention of the Court.

> Moreover, the manner in which Kronowitz handled the gains from his Levy investments does not support a finding that he was simply mistaken, as opposed to reckless under the circumstances. Once Kronowitz learned that his investments with Levy had generated significant gains, he gave instructions for the funds to be transferred first to the Caymans, and then to the Trust, rather than directly to the Trust's bank account in the United States. In addition, he admittedly opened the Cayman Accounts to keep assets out of reach of potential creditors, like Mogerman, based upon advice he heard during a CPE course; but without conducting any follow- up to determine the potential tax effects of maintaining offshore accounts. See ECF No. [41] at 11, ¶ 27 ("The purpose of opening these [Cayman Accounts] was that if Kronowitz was to be sued for malpractice, such funds could not be reached by the potential creditor."). Kronowitz testified at trial that in connection with the advice he heard regarding moving assets offshore, "[t]hat's when I opened the account in the Caymans

[19] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

> and put some money over there. I didn't have a lot, but I put some." And while Kronowitz insists that there was no intent to defraud the IRS, no fraudulent intent is required for a finding of willfulness in the FBAR context.[20]

Finally, the Court rejected the claim that his declining health had compromised his cognitive abilities:

> In support of the defense that his failure to file FBARs was not willful or reckless, Kronowitz introduced evidence at trial. That evidence consisted of the testimony of his daughter, Tracy Falkowitz, and his wife, Sybil Kronowitz, that he has experienced significant declines in his health and memory in recent years. However, the evidence does not establish that Kronowitz's declining health affected his behavior during the relevant time period, such that it would support a finding that his violations were not reckless. Although the Court is sympathetic to Kronowitz's recent lapses in memory and additional health complications, there was no medical evidence presented at trial to establish that Kronowitz's cognitive abilities were compromised during the relevant tax years. Rather, the evidence demonstrates that his actions related to the handling of his accounts and the gains from his investments with Levy were purposeful and deliberate.[21]

Court's Summary – The CPA Should Have Known

The Court concludes the opinion as follows:

> Based upon Kronowitz's background and experiences as a CPA and tax preparer, and the totality of his actions in this case, the Court finds 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. Furthermore, he was in a position to find out for certain very easily, had he taken the time to either conduct independent research, or consult with another person more knowledgeable on tax law as to whether any additional reporting requirements might apply to him.[22]

[20] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[21] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

[22] *United States v. Kronowitz*, USDC SD Fla., Case No. 19-cv-62648-BLOOM/Valle, June 3, 2021

SECTION: 581
A BUSINESS CONSISTING OF ISSUING MONEY ORDERS AND PROVIDING PAYMENT PROCESSING IS NOT A BANK UNDER IRC §581

Citation: MoneyGram International Inc. et al. v. Commissioner, CA5, Case No. 20-60146, 6/1/21

Back in November of 2016 we wrote about the Fifth Circuit reversing the holding of the Tax Court in a dispute that revolved over whether MoneyGram is a bank for tax purposes.[23] The Fifth Circuit found that the Tax Court had not applied the proper test to determine if MoneyGram was a bank—so the appellate court sent the case back to the Tax Court for a determination of whether MoneyGram was a bank using a different standard.

Nearly five years later, the case is back before the Fifth Circuit Court of Appeals, as the Tax Court determined yet again that MoneyGram was not a bank under IRC §581, so was not able to write off losses from mortgage backed securities as an ordinary rather than capital loss. As a C corporation, capital losses can only be deducted against capital gains. This time, the Fifth Circuit sustained the decision of the Tax Court, finding that MoneyGram was not a bank.[24]

What MoneyGram Does

The Fifth Circuit gave the following description of what MoneyGram's business consisted of:

> MoneyGram offers various money transfer services to individuals and financial institutions. It may be best known for wiring money around the world, but it does not contend those wires or other "money transfers" make it a bank. It contends that two other services do make it a bank: "money orders" and "official check processing."
>
> MoneyGram sells money orders through agents like WalMart or convenience stores. To purchase a money order, a customer gives the agent cash in exchange for a blank money order. The cost is the amount of the money order plus a fee. The customer fills in her name, the name of the recipient, and her signature. She might use the money order to pay bills, send a gift, or make purchases from sellers who do

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[23] Edward Zollars, "Fifth Circuit and Tax Court Disagree on Whether Money Services Business Is a Bank," *Current Federal Tax Developments* website, November 19, 2016, https://www.currentfederaltaxdevelopments.com/blog/2016/11/19/fifth-circuit-and-tax-court-disagree-on-whether-money-services-business-is-a-bank (retrieved June 4, 2021)

[24] *MoneyGram International Inc. et al. v. Commissioner,* CA5, Case No. 20-60146, June 1, 2021, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/fifth-circuit-affirms-moneygram-is-not-a-bank/76k3d (retrieved June 5, 2021)

not accept cash. Most recipients present and redeem the money order within ten days of its purchase.

MoneyGram also offers payment processing services to financial institutions, including the processing of "official checks." Official checks include cashier's checks and bank checks. Compared to personal checks, which may bounce, these checks assure payment. Financial institutions both provide these checks to their customers (for example, to close on a home) and use them to pay the institution's own obligations. While the financial institution issues the official checks, MoneyGram processes them. At the end of each business day, the financial institution reports the dollar amount of official checks it issued that day and then transfers that amount to MoneyGram, usually the following morning. When the payee later presents the check for payment, the funds held at MoneyGram are drawn down. In other words, the financial institution has an account with MoneyGram that depletes and replenishes in a daily cycle based on how many official checks the financial institution issued the day before. Before the first day the financial institution issues official checks, it gives MoneyGram funds "equal to its anticipated average daily volume of official checks," to cover any checks presented for payment before the first daily transfer.[25]

What is a Bank?

IRC §581 defines a bank as:

> …a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia) or of any State, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under authority of the Comptroller of the Currency, and which is subject by law to supervision and examination by State or Federal authority having supervision over banking institutions.[26]

As the panel points out, this literally first defines a bank as a bank, but once we get past the circular part of the definition the opinion points out that there are three requirements MoneyGram must meet in order to be a bank under IRC §581:

- The entity must be a "bank" within the common understanding of the term;
- A substantial part of the entity's business must consist of deposits, loans, and discounts; and
- The entity must be subject to state or federal regulation.[27]

[25] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

[26] IRC §581

[27] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

The panel notes that the original decision of the Circuit provided a look at what it generally means to be a bank:

> Our focus is on the first and most fundamental requirement — that the taxpayer be a bank under the common understanding of that term. We previously explained that the "bare requisites" of a traditional bank are:
>
> > (1) "the receipt of deposits from the general public, repayable to the depositors on demand or at a fixed time;" (2) "use of deposit funds for secured loans;" and (3) "the relationship of debtor and creditor between the bank and the depositor." *MoneyGram*, 664 F. App'x at 391 (quoting *Staunton Indus. Loan Corp. v. Comm'r,* 120 F.2d 930, 933–34 (4th Cir. 1941)).[28]

Does MoneyGram Receive Deposits as a Bank?

The panel discusses what represents the acceptance of deposits by a bank in order to determine if that describes what MoneyGram does:

> It makes sense to start with deposits. "Strictly speaking the term bank implies a place for the deposit of money, as that is the most obvious purpose of such an institution." *Oulton v. German Sav. & Loan Soc'y*, 84 U.S. 109, 118 (1872); see also *Staunton*, 120 F.2d at 933 (quoting multiple dictionary definitions that include accepting deposits as a function of banks); Adam J. Levitin, *Safe Banking: Finance and Democracy*, 83 U. CHI. L. REV. 357, 366. (2016) ("The taking of deposits is what makes a bank a bank.").
>
> And deposits have always been tied up with the need for safekeeping. *Oulton*, 84 U.S. at 118; see *Levitin*, supra, at 366 ("Banks' distinctive function is to provide safekeeping for deposits."); Richard A. Lord, *The Legal History of Safekeeping and Safe Deposit Activities in the United States*, 38 ARK. L. REV. 727, 727 (1985) ("Historically, the safekeeping function is perhaps the oldest function in banking.").[29]

Moneygram argued that it did accept deposits from customers for its money-order and official-check functions, thus meeting the primary condition to be a bank.

Buying a Money Order is Not Placing Funds on Deposit

The panel first looked at the issuance of money orders to see if this represented a receipt of deposits by MoneyGram. The taxpayer argued that this is exactly what is happening:

> MoneyGram contends that when a customer buys a money order, the customer is placing funds with MoneyGram for safekeeping, at least

[28] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

[29] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

> until such time as the recipient of the money order presents it for payment.[30]

The Tax Court on remand did not accept that view:

> The tax court rejected this argument, likening a money order to the purchase of a gift card rather than a deposit in a bank account.[31]

The panel agreed with the Tax Court on this point.

> … Although a customer views the money order as a secure way to transfer funds, it does not follow that the purchaser is placing money with MoneyGram for safekeeping. See *Levitin*, supra, at 367 (describing the making of secure payments as ancillary to, but distinct from, safekeeping).[32]

The panel finds that the primary purpose of purchasing a money order is not to place money on deposit for safekeeping:

> …[W]hen it comes to money orders, the "purpose of safekeeping" inquiry is getting ahead of things because a money order customer is never keeping its funds with MoneyGram at all. Consider someone who goes to a convenience store to buy a $100 MoneyGram money order that will be used to pay a utility bill. The customer hands over a $100 bill, plus a few more dollars for the fee, to MoneyGram's agent. In exchange, the agent gives the customer a blank money order. At this point, the $100 belongs to MoneyGram (held in trust for the company by the agent). This is largely true of bank deposits too. But unlike a bank that incurs a corresponding liability to the customer who gave it the $100, MoneyGram owes the $100 not to the money order purchaser but to the person or business listed on the payee line. Cf. *Morris Plan Bank of New Haven v. Smith*, 125 F.2d 440, 442 (2d Cir. 1942) (asking whether the obligations of the entity receiving the "deposit" mirror the obligations of a bank to a traditional depositor). As a result, the purchaser of a money order is not keeping its money with MoneyGram.[33]

The taxpayer objects that nothing stops the purchaser of the money order from putting his/her own name on the payee line, but the panel does not find this argument persuasive:

> But even assuming these uncommon occurrences could establish that customers purchase money orders for the purpose of safekeeping, the mechanics of the money order are still inconsistent with safekeeping. When a customer deposits $100 in a bank, she can later withdraw $10, or $50, or the full $100. That is consistent with the notion of

[30] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

[31] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

[32] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

[33] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

> safekeeping. *Engel v. O'Malley*, 219 U.S. 128, 136 (1911). It is still the depositor's money, just being held by the bank. But the purchaser of a $100 money order cannot go back to the convenience store and ask for $20 back. Any return is for the full $100 (but not the fee) just like when one receives a full refund for returning a shirt or toaster. This ability to return is a common feature of products. That is the label a MoneyGram executive used to describe the money orders to a Senate Committee: "just another product [that its agent convenience stores] offer to their customers, like milk or bread." *An Update on Money Services Businesses Under Bank Secrecy and USA Patriot Regulation: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 109th Cong. 74 (2005) (statement of Dan O'Malley, Vice President, MoneyGram Int'l, Inc.). Buying a product is not depositing money for safekeeping. Customers buying a product are doing the opposite of keeping their money; they are spending it.[34]

But, MoneyGram argues, the money order is just like the personal checks that depositors use to assign funds in their bank accounts to third parties. Again, the panel rejects this view.

> It is true that a money order and a personal check are quite similar. The analogy breaks down, though, because writing a personal check is not turning over money for safekeeping. Look at your bank statement — a check is listed as a withdrawal from the checking account, not a deposit. MUNN ET AL., *supra*, at 250 (9th ed. 1993) (deposit banking includes "receiving deposits" and separately "paying them out by check"). It is the checking account, not the checks themselves, that involves safekeeping. Because the withdrawals from a checking account will rarely correspond 1:1 with the deposits, a checking account usually carries a balance (secured by FDIC insurance, something MoneyGram does not provide for its money orders, which if lost can no longer be used by the purchaser). Checking accounts thus serve a safekeeping function, not just a money-transferring one. *Id.* at 179 (listing, among the benefits of checking accounts, removing the risk of losing money and preventing loss of money by robbery). In contrast, a money order purchaser does not have an account with MoneyGram. A money order account would not make sense as there is no balance to track. In other words, there are no funds being kept with MoneyGram.[35]

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[34] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

[35] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

Payment Processing and Official Checks – Still Not Used for Safekeeping

But what about the financial institutions using MoneyGram for payment processing—they seem to be making deposits with MoneyGram and keeping a running balance.

> Those institutions do have an account with MoneyGram. And there is a balance, reflecting the funds banks have transferred to MoneyGram to cover official checks that have been issued but not yet presented for payment. The "first day settlement," which functions as a sort of overdraft protection in the event the bank does not make the required daily payment for checks it has just issued, is also part of the positive balance. MoneyGram claims the first-day-settlement funds are "deposits" as that money is not already obligated to the third-party recipient listed on an issued check.[36]

Isn't this banking? The panel decides no because these deposits are not primarily for the purpose of safekeeping:

> We recognize that because the financial institution still owns this first-day-settlement money, it is at least "keeping" those funds with MoneyGram. The problem is that a financial institutions is not leaving these funds with MoneyGram for safekeeping; it is doing so to fulfill a contractual requirement of using the check processing service.
>
> MoneyGram compares the financial institution's "account" with MoneyGram to a personal checking account and emphasizes the security of the transaction. But we agree with the tax court that the obligatory nature of the first-day settlement makes it more like a tenant's security deposit or an attorney's retainer. MoneyGram is requiring a financial cushion to guard against nonpayment, just as an attorney does in requiring a retainer before providing legal services. Although money "kept" with the attorney via a retainer may be relatively safe, the client is not giving the attorney that money for safekeeping. As the tax court noted, the client is leaving those funds with the attorney "to satisfy the demand of the other contracting party for assurance of payment." The same is true with the first-day settlement financial institutions give MoneyGram before official checks start to issue.
>
> Fulfillment of a contractual obligation thus explains why financial institutions are leaving funds with MoneyGram. We see no evidence, and more fundamentally no reason, that the financial institutions would be leaving the funds with MoneyGram for safekeeping. As the tax court noted, financial institutions "presumably have ample means of keeping their cash safe." See also Levitin, supra, at 366 (noting that banks typically "invest in security measures like fireproof vaults, security guards, and computer security systems"). They are not like

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[36] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

> individuals who put money in a bank because that is safer than leaving cash in a wallet.[37]

As well, the financial institutions cannot demand repayment of those first-day settlement funds:

> In addition to being inconsistent with a safekeeping purpose, the obligatory nature of the first-day settlement means another feature of deposits is missing: the depositor's ability to demand repayment of funds.
>
> See *MoneyGram*, 664 F. App'x at 392; MUNN ET AL., supra, at 68 ("Checking account deposits are payable on demand."). This is really just another angle of the safekeeping requirement. Cf. *Oulton*, 84 U.S. at 118 (observing that safekeeping involves a depositor leaving a valuable item with a bank "until the depositor should see fit to draw it out for use"). When a depositor voluntarily leaves funds with a bank because that is a safer place to keep the money than under the mattress, the depositor can withdraw the money whenever she likes or, in the case of an instrument like a certificate of deposit, on a date certain. That is not true for the first-day settlement. As long as the financial institution continues to use MoneyGram's check processing service, it cannot get its money (the first-day settlement) back.[38]

The panel concludes that while this service may look more like banking, in the end it still does not qualify under the IRC §581 definition.

> The fact that the service MoneyGram is selling — processing of official checks — relates to banking may give this arrangement the veneer of a banking relationship. But in substance MoneyGram is selling a service that just happens to involve checks. Consider someone without a checking account who gives a friend $20 to write a $20 check to pay a bill. The checkwriter will have the $20 for a few days before the check clears. But in handing over a $20 bill, the person gave money to the friend to buy a check, not for safekeeping.[39]

MoneyGram is Not a Bank

The opinion concludes:

> Examining the substance of MoneyGram's business thus confirms how the company has long described itself on its tax returns: as a "nondepository" institution. And without deposits, MoneyGram cannot be a bank.[40]

[37] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

[38] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

[39] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

[40] *MoneyGram International Inc. et al. v. Commissioner*, CA5, Case No. 20-60146, June 1, 2021

While most of us don't deal with "kind of" banks to which this case would directly apply, it's still instructive on a couple of levels. First, the opinion provides a look at how courts approach attempting to unravel what Congress meant in cases where Congress itself is not really clear—"a bank is a bank" is a definition that fails to define, but still what we have to work with since it's what Congress wrote.

Second, it also illustrates the importance of not overreading an opinion, especially an appellate opinion that, while reversing the trial court, sends the case back to the court for further proceedings. In this case, while the Fifth Circuit in 2016 did reverse a Tax Court decision holding that MoneyGram was not a bank, it did not ever say MoneyGram *was* a bank—just that if it wasn't one, it wasn't for the reasons the Tax Court had given.