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CLARIFYING PROVISIONS ON THE ASSESSMENT AND COLLECTION OF FOREIGN INFORMATION REPORTING PENALTIES (IRC §§6038, 6038A, 6038B, 6038C, 6038D, 6039F, 6046, 6046A, 6048)

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[1] The comments contained in this paper are the individual views of the authors who prepared them, and do not represent the position of the California Lawyers Association.

[2] Although the authors and/or presenters of this paper might have clients affected by the rules applicable to the subject matter of this paper and have advised such clients on applicable law, no such participant has been specifically engaged by a client to participate on this project.

EXECUTIVE SUMMARY

Under *National Federation of Independent Businesses v. Sebelius*, 567 U.S. 519 (2012), whether a penalty is deemed a tax or assessed, paid, and collected in the same manner as a tax turns upon the language of the statute. Since the employee-mandate penalty of the Affordable Care Act was not deemed a tax, unlike the penalties and additions contained in Chapters 68A and 68B of the Internal Revenue Code (the "Code"), the Supreme Court held the Anti-Injunction Act did not apply to a suit to determine the legality of that penalty.

Part III, subparts A and B, of Chapter 61A of the Code contains provisions (IRC §§ 6038 – 6039D, 6039F, 6046, 6046A and 6048) requiring taxpayers to file reports concerning certain foreign transactions and assets. By regulations, many of these reports, such as Forms 5741 and 8938, are required to be filed as part of the taxpayer's income tax return. Failure to comply with the reporting requirements can result in draconian penalties. Failure to file a required return can also stay the commencement of the statute of limitations on assessment. These penalties are usually raised during an audit of a taxpayer's income tax returns.

Neither Chapter 61, nor any other part of the Code contains provisions deeming the penalties for failure to comply with IRC §§ 6038 – 6038A or 6039F a tax or providing that they be assessed, paid and collected in the same manner as a tax. Despite the lack of these provisions, the Internal Revenue Service ("IRS") takes the position that it can assess and collect these penalties in the same manner as the assessable penalties contained in Chapter 68B without giving a taxpayer a right to a pre-assessment appeal or the right to petition the Tax Court.[3]

This paper argues that the Service's position is incorrect. Because the Code contains no provision specifying that the penalties imposed under IRC §§ 6038 – 6038A or 6039F are deemed a tax or are to be assessed and collected in the same manner as a tax, the Code sections authorizing the Secretary to assess and collect taxes do not apply. Instead, the only method by which the Secretary can collect these penalties is by referring the case to the Department of Justice to institute a lawsuit to collect any liability that accrues under these sections. Because the Secretary cannot

[3] Internal Revenue Manual ("IRM") ¶ 20.1.9.1[2] (10/24/13).

use his administrative collection powers, including lien and levy, a taxpayer whom the Secretary claims is liable for one of these penalties is not entitled to a collection due process hearing. And because these penalties are not deemed a tax, the Anti-Injunction Act[4] would not bar a taxpayer from bringing an injunction action to determine liability for these penalties.

This paper proposes that a section be added to Chapter 61AIIIA similar to IRC §§ 6665 and 6671 providing that the penalties contained therein be assessed, paid and collected in the same manner as a tax and be deemed a tax. Because failure to file the returns required under IRC §§ 6038, 6038A, 6038B, 6038D, 6046, 6046A, and 6048 suspends the running of the statute of limitations on assessment,[5] we further propose that foreign-information reporting penalties for failure to comply with these sections be subject to deficiency procedures.

[4] IRC § 7421 (all references to IRC refer to Title 26 of the United States Code, unless otherwise stated.

[5] IRC § 6501(c)(8)(A).

DISCUSSION

I. BACKGROUND.

A. Introduction.

Part III, subparts A and B, of Chapter 61 of the Internal Revenue Code (Title 26 United States Code) contains several provisions mandating the filing of information returns concerning foreign assets, investments and transactions by United States persons. The provisions mandating the information returns authorize the Secretary to prescribe the manner and time in which the information is to be reported.[6]

Failure to file or provide information required by these statutory provisions and the regulations promulgated thereunder can result in the imposition of substantial monetary penalties. Penalties for violations of foreign information returns required by Part III, Subpart A, of Chapter 61 are incorporated into the statutes mandating the filing of the reports. Penalties for violation of foreign information returns required under Part III, Subpart B, of Chapter 61 are contained in Chapter 68B. The Forms, the Code and Treasury Regulations (Title 26, Code of Federal Regulations) requiring the filing of the returns, and the Code sections imposing the applicable penalties are listed below:

Form	Title	Enabling Sections	Penalty Section
5471	Information Return of U.S. Persons with Respect to Foreign Corporations	6038 (owner of controlling stock interest); 1.6038-1(a)(2), (i)	6038(b), (c)
5471	Information Return of U.S. Persons with Respect to Foreign Corporations	6046 (officer or director with over 10% of stock);	6679

[6] Secs. 6038(a)(2), 6038A(a), 6038B(a), 6038C(a)(1), 6038D(h), 6039F(c), 6046(b), 6046A(n), (c), and 6048(d)(3).

		1.6046-1(c), (j)	
5472	Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business	6038A (foreign-owned U.S. corporation); 1.6038A-2(a)(1), (d)	6038A(d)
5472	Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business	6038C (foreign corporation in business in U.S.); 1.6038C-1 incorporates 1.6038-1 through 1.6038-7	6038C(c)
8938	Statement of Foreign Financial Assets	6038D; 1.6038-2(a)(1)	6038D(d)
926	Return by a U.S. Transferor of Property to a Foreign Corporation	6038B; 1.6038B-1(b)(1)	6038b(c)
3520	Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts	6048 (transactions with foreign trust);16.3-1(a), (e)(1)	6677
3520	Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts	6039F (receipt of foreign gift)	6039F(c)
3520-A	Annual Information Return of Foreign Trust With a U.S.	6048; 404.6048-1(a)(1)	6677

	Owner		
8865	Return of U.S. Persons With Respect to Certain Foreign Partnerships	6046A; 1.6046A-1(a), (d)	6679

The penalties imposed by these provisions can be severe, especially if the Service determines that the taxpayer has failed to file required reports for multiple years or for large gifts:

Section Violated	Penalty Section	Penalty Amount
6038	6038(b)	$10,000 plus $10,000 per month continuation penalties up to $50,000
6038A	6038A(d)	$25,000 plus $25,000 per month continuation penalty with no statutory maximum
6038B	6038B(c)	10% of value of property exchanged or contributed up to $100,000 (no maximum if failure was intentional)
6038C	6038C(c)	$25,000 plus $25,000 per month continuation penalty with no statutory maximum
6038D	6038D(d)	$10,000 plus $10,000 per month continuation penalties up to $50,000
6039F	6039F(c)	5% of the amount of the foreign gift for each month for which the failure continues, up to a maximum of 25%
6046	6679	$10,000 plus $10,000 per month continuation penalties up to $50,000
6046A	6679	$10,000 plus $10,000 per month continuation penalties up to $50,000
6048(a)	6677	Greater of $10,000 or 35% of the "gross reportable amount" with a continuation penalty of $10,000 for each 30 day period such failure continues
6048(b)	6677(a), (b)	Greater of $10,000 or 5% of the "gross reportable amount" with a continuation penalty of $10,000 for each 30 day

		period such failure continues

These penalties can be stacked, in that penalties can be assessed for multiple years and different penalties can be assessed for the same conduct so that a person who fails to report a controlling interest in a foreign corporation could potentially be liable for penalties under IRC §§ 6038 *and* 6038D. The IRS's stated position is that these penalties "unless otherwise noted, are assessable penalties and are not covered by deficiency procedures of IRC 6211 through IRC 6215 (relating to deficiency procedures for income, estate, gift, and certain excise taxes). Assessable penalties are paid upon notice and demand. For assessable penalties, there is no 30-day letter, no agreement form, and no notice requirements prior to assessment."[7] The penalties for violation of IRC §§ 6046, 6046A and 6048 are contained in Chapter 68B, which chapter is titled "Assessable Penalties."

Nowhere in the Internal Revenue Code, however, is there any provision characterizing the penalties imposed under IRC §§ 6038(b), 6038A(d), 6038B(c), 6038D(d), or 6039F(c) as "assessable penalties" or providing that they are to be assessed or collected in the same manner as a tax. This is to be contrasted to other penalties, such as those contained in Chapter 68A, which are assessed and collected in the same manner as a tax,[8] and the individual mandate penalty under the Affordable Care Act, which is "assessed and collected in the same manner as an assessable penalty."[9]

This paper takes the position that, unlike the penalties contained in chapter 68B, the penalties contained in chapter 61 are not assessable penalties within the meaning of the Internal Revenue Code. This affects the ability of the IRS to assess and collect the penalty and the rights and remedies of the taxpayer. Only Congress can address this situation.

B. Foreign Information Reports Subject to Penalties Under Chapter 68B.

United States persons who are officers, directors or controlling shareholders of foreign corporations have been required to supply

[7]Internal Revenue Manual ¶20.1.9.1.1.2 (10-24-2013).
[8] IRC § 6665(a).
[9] IRC § 5000A(g)(1).

information to and file reports with the IRS for at least 80 years. [10, 11] Failure to file these returns could result in a misdemeanor.[12]

Section 6035 of the Internal Revenue Code of 1954 consolidated IRC §§ 338 and 339 of the 1939 Internal Revenue Code. Like prior IRC §§ 338 and 339, a willful failure to file the reports or provide the information required by IRC § 6035 could result in a misdemeanor.[13] There were, however, no civil penalties for failure to file these returns or provide the required information.[14]

In 1960, Congress added two sections to the Internal Revenue Code imposing a duty to file information returns relating to foreign corporations: IRC § 6038[15] and IRC § 6046.[16] Section 6046 imposed upon every United States citizen or resident who was an officer or director, or who owned 5% or more of the value of, a foreign corporation to file a return within 60 days of the creation, formation or reorganization of the corporation. Since both sections were contained in Chapter 61AIII, there were no monetary penalties imposed for failure to file the returns required by either of these sections.

Concerned about tax avoidance by United States citizens or residents through the use of foreign accumulation trusts,[17] in 1962 Congress enacted IRC § 6048.[18] That section mandates the filing of reports of a) the creation or transfer of property to a foreign trust by a United States person or b) the death of a United States person who was treated as the owner of all or any portion of a foreign trust under the grantor trust rules or whose gross estate includes any portion of a foreign trust.

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[10] IRC § 338, Internal Revenue Code of 1939, imposed upon United States persons who were officers and directors of a "foreign personal holding company" a duty to file monthly and annual returns.
[11] IRC § 339, Internal Revenue Code of 1939, imposed upon United States persons who directly or indirectly owned 50% or more of the value of the outstanding shares of stock of a "foreign personal holding company" a duty to file monthly and annual returns.
[12] IRC § 340, Internal Revenue Code of 1939.
[13] IRC § 7203.
[14] IRC § 6035 was contained in part III, subchapter A of chapter 61 of the Internal Revenue Code of 1954. IRC § 6651(a) expressly excluded returns required under ch. 61AIII from the failure to file penalty. A person obligated to file a return under IRC § 6035 who willfully failed to do so could be charged with a misdemeanor under IRC § 7203.
[15]Sec. 6(a), Pub. L. 86-780, applicable to annual accounting periods beginning after December 31, 1960. IRC § 6038 is discussed in greater detail in Part C, below.
[16] Sec. 7(a), Pub. L. 86-780, applicable to annual accounting periods beginning after December 31, 1960.
[17] Senate Report on Revenue Act of 1962, Sen. Rpt. 1881, pp. 766-767.
[18] Sec. 7, Pub. L. 87-834. Pub. L. 87-834 also amended the heading of IRC § 6046, amended subsecs. (a), (b) and (c) and added subsecs. (d) and (e) and re-designated subsec. (d) as subsec. (f).

As part of the Revenue Act of 1962, Congress for the first time also imposed civil monetary penalties for failure to file certain foreign information returns. Section 6677[19] imposed a civil penalty upon a person required to file a return under IRC § 6048 who failed to file the returns when due or failed to provide the required information. The amount of the penalty was equal to 5 percent of the amount transferred to the foreign trust, but not to exceed $1,000, unless the person could show that the failure was due to reasonable cause. The penalty was explicitly exempt from the deficiency procedures contained in subchapter B of chapter 63.[20]

Congress also enacted IRC § 6679,[21] which imposed a civil penalty of $1,000 on any person required to file a return under IRC §§ 6035 or 6046 who failed to do so or who failed to provide the information required under those sections, unless it was "shown that such failure is due to reasonable cause."[22] Like the penalty imposed by IRC § 6677, the IRC § 6679 penalty was explicitly exempted from deficiency procedures.[23]

Sections 6677 and 6679 are contained in subchapter B of Chapter 68 of the Internal Revenue Code. Under IRC § 6671, the penalties imposed by IRC §§ 6677 and 6679 were to be paid upon notice and demand and were to be "assessed and collected in the same manner as taxes" and any reference to tax in the Internal Revenue Code was "deemed also to refer" to the penalties imposed by these two sections.[24]

As part of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Congress enacted IRC § 6046A.[25] The section required any United States person who acquired an interest in or disposed of any part of an interest in a foreign partnership to file a return with the IRS if the person holds, directly or indirectly, at least a 10% interest in the partnership either before or after the acquisition or disposition. Section 6679 was

[19] Sec. 7(g), Pub. L. 87-834, effective October 16, 1962. In 2004, IRC § 6035, which required reports from officers, directors and shareholders of foreign personal holding companies, was repealed by the American Jobs Creation Act ("AJCA"), Sec. 413(c)(26), Pub. L. 108-357, which also amended IRC § 6679 to remove reference to IRC § 6035. Sec. 340(b)(1), (2), Pub. L. 108-357.
[20] IRC § 6677(e), formerly IRC § 6677(b).
[21] Sec. 20(c), Pub. L. 87-834, effective October 16, 1962.
[22] IRC § 6679(a).
[23] IRC § 6679(b).
[24] IRC § 6671(a).
[25] Sec. 405, Pub. L. 97-248.

contemporaneously amended to be applicable to failures to file returns or provide information required under IRC § 6046A.[26]

The Small Business Jobs Protection Act of 1996 increased the amount of the penalty imposed under IRC § 6677 from 5% of the value transferred (not to exceed $1,000) to the greater of 35% of the "reportable amount" or $10,000, with reportable amount being defined as:

- The gross value of the property involved in the event for a failure relating to IRC § 6048(a), which relates to i) the creation or transfer of money or property to a foreign trust by a United States person, or ii) the death of a United States person who is either treated as the owner of any portion of a foreign trust under the grantor trust rules or whose gross estate includes any portion of a foreign trust;

- The gross value of the trust's assets treated as owned by the United States person under IRC § 6048(b)(1), relating to reports filed by a person who is treated as the owner of any portion of the foreign trust; and

- The gross amount of the distribution required to be reported under IRC § 6046(c), relating to reports by United States persons who receive distributions from foreign trusts during the taxable year.

If a person liable for a penalty under 6677(a) fails to file the required report within 90 days after written notice from the IRS, the amount of the penalty increases by $10,000 for each 30-day period (or fraction thereof) during which the failure continues.[27] The continuation penalties are to be reduced so that the total penalty does not exceed the gross reportable amount.[28] Where the violation is for failure to file a return required by IRC § 6048(b), the maximum amount of the initial penalty is the greater of 5% of the gross amount or $10,000.[29] The penalty does not apply if the failure was due to "reasonable cause and not due to willful neglect," but the fact that the

[26] Sec. 405(b), Pub. L. 97-248, effective for acquisitions and dispositions of foreign partnership interests occurring after September 3, 1982.
[27] IRC § 6677(a).
[28] IRC § 6677(a).
[29] IRC § 6677(b).

person could be subjected to criminal or civil penalties by a foreign jurisdiction for disclosing the required information is not reasonable cause.[30]

The following year, the Taxpayer Relief Act of 1997 increased the penalty under IRC § 6679.[31] The penalty for failing to file the report when due or providing the required information was increased to $10,000.[32] Where the failure continues more than 90 days after notice from the IRS, the amount of the penalty was increased by $10,000 for each 30-day period or fraction thereof during which the failure continues after the ninetieth day, with the maximum continuation penalty being $50,000.[33] Unlike the penalty imposed by IRC § 6677, the taxpayer is not required to show lack of willful neglect to establish reasonable cause. Theoretically, potential civil or criminal penalties by a foreign jurisdiction for disclosure may constitute reasonable cause.

Chapter 68B contains the following additional sections imposing penalties for failing to file returns or provide information relating to foreign persons or foreign activities of United States persons:

- Section 6652(f), which imposes a penalty of $25 a day for a failure by a foreign person to file a return regarding direct investments in property in the United States, as required by IRC § 6039C, with a maximum penalty equal to the lesser of $25,000 or 5% of the aggregate fair market value of all United States real property owned by the person;

- Section 6686, which imposes a penalty of $25 for the failure of a DISC or FSC to provide information required under IRC § 6011(c) (up to a maximum of $25,000) and $1,000 for failure of a DISC or FSC to file a return required by IRC § 6011(c);

- Section 6688, which imposes penalties of $1,000 for a) failing to file Form 8898 regarding residence in a possession of the United States, b) failing to file forms for allocation of income tax to Guam and c) failing to file forms for allocation of income tax to the United States Virgin Islands; and

[30] IRC § 6677(d).
[31] Sec. 1143(b), Pub. L. 105-34.
[32] IRC § 6679(a).
[33] IRC § 6679(b).

- Section 6712, which imposes a $1,000 penalty ($10,000 in the case of a C corporation) for failing to disclose a treaty-based return position as required by IRC § 6114.

Because the penalties in IRC §§ 6677, 6679, 6652, 6688 and 6712 are all contained in chapter 68B, they are subject to IRC § 6671,[34] which provides:

> (a) Penalty assessed as tax: The penalties and liabilities provided by this subchapter shall be paid upon notice and demand by the Secretary, and shall be assessed and collected in the same manner as taxes. Except as otherwise provided, any reference in this title to "tax" imposed by this title shall be deemed also to refer to the penalties and liabilities provided by this subchapter.

Because these penalties are contained in subtitle F of the Internal Revenue Code, and are not based on an underpayment of income, estate, gift or an excise tax, deficiency procedures do not apply.[35] As a result, the IRS can assess these penalties without issuing a notice of deficiency[36] under the procedures contained in subchapter A of chapter 63 and the regulations promulgated thereunder. Notice and demand for payment would need to be made within sixty days of assessment, with notice being left at the taxpayer's dwelling or usual place of business or being mailed to the taxpayer's last known address.[37] Since the chapter 68B penalties are deemed a "tax," the taxpayer must be provided notice of lien filing or of intent to levy and the right to a collection due process hearing.[38]

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[34] IRC § 6665(a) similarly provides that the additions to tax and penalties contained in Chapter 68A are to be paid upon notice and demand, assessed and collected in the same manner as a tax and any reference in the Internal Revenue Code to "tax" is deemed to the additions to tax and penalties of Chapter 68A.

[35] IRC § 6212 requires that a notice of deficiency be issued when the Secretary determines a deficiency with respect to any tax imposed under subtitle A (income tax), subtitle B (estate and gift taxes) or chapter 41, 42, 43, or 44 (certain excise taxes).

[36] See *Shaw v United States*, 331 F.2d 493 (9th Cir. 1964) (since the IRC § 6672 trust fund recovery penalty was under subtitle F and related to employment tax under subtitle C, deficiency, procedure did not apply and the penalty could be assessed without issuance of a notice of deficiency); *Thornton v. Commissioner*, 60 T.C. 977 (1973) (accord).

[37] IRC § 6303(a). Absent proper notice and demand, the IRS may not collect the tax administratively through its lien and levy authority. *Behren v United States*, 82 F. 3d 1017 (11th Cir. 1996); *In re Resyn Corp.*, 945 F.2d 1079 (3rd Cir. 1991); *United States v. Berman*, 823 F.2d 1053 (6th Cir. 1987).

[38] IRC §§ 6320, 6330.

C. Foreign Information Reports for Which Penalties Are Imposed Under Chapter 61.

As noted in Part B, above, IRC § 6038 was enacted in 1960. It required a domestic corporation that controlled any foreign corporation to furnish information to the Secretary about the foreign corporation and any subsidiaries of the foreign corporation. Failure to furnish the required information could result in the reduction of any foreign tax credits with respect to the controlled foreign corporation.[39] The maximum amount by which the foreign tax credit would be reduced was the greater of $10,000 or the income of the foreign corporation for its annual accounting period with respect to which the failure occurred. There was no civil monetary penalty for failing to furnish the required information.

A civil monetary penalty was added as subsection (b) as part of TEFRA.[40] As originally enacted, subsection (b) imposed a penalty of $1,000 for each annual accounting period for which the required information was not furnished. If the failure continued for more than 90 days after notice of the failure was mailed to the taxpayer, there was an additional $1,000 penalty for each 30-day period for which the failure continued. The maximum continuation penalty was $24,000. There was a reasonable cause exception to the penalty in that the duty to furnish information and provide records did not begin until the last day on which reasonable cause existed for non-compliance.[41]

In the Taxpayer Relief Act of 1997, IRC § 6038 was amended to apply to "any foreign business entity," not just corporations.[42] The 1997 Act also amended subsection (b) to increase the civil monetary penalty to $10,000 with a continuation penalty of $10,000 for each 30-day period, for a maximum continuation penalty of $50,000,[43] and to make the penalty applicable to any "foreign business entity," and not just foreign corporations, controlled by the United States person.[44]

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[39] IRC § 6038(b), Internal Revenue Code of 1954.
[40] Pub. L. 97-248, sec. 338(a).
[41] IRC § 6038((c)(4)(B).
[42] Pub. L. 105-34, sec. 1142(a) amended subsection (a) to read as it currently does.
[43] Pub. L. 105-34, sec. 1142(c)(1)(A)-(B).
[44] Pub. L. 105-34, sec. 1142(e)(1)(B).

Besides expanding the scope of IRC § 6038 and imposing a monetary civil penalty for failure to comply, TEFRA added IRC § 6038A.[45] Originally, IRC § 6038A required a domestic corporation that was 25-percent foreign owned to file reports that would contain information to allow the IRS to determine the correct tax treatment of transactions with related parties. Subsection (d) imposed a $1,000 penalty for failure to provide the required information. If the failure continued more than 90 days after mailing of notice to the taxpayer, there was a continuation penalty of $1,000 for each 30-day period up to a maximum continuation penalty of $24,000. There was a reasonable cause exception to the penalty in that the duty to furnish information and provide records did not begin until the last day on which reasonable cause existed for non-compliance.[46]

As part of the Omnibus Budget Reconciliation Act of 1989, the penalty provision of IRC § 6038A was amended to (a) make it applicable to failures to furnish the required information or to maintain required records, and (b) remove the $24,000 cap on the continuation penalty.[47] The Tax Cuts and Jobs Act of 2017 amended the penalty provisions to make the initial penalty $25,000 and to increase the continuation penalty to $25,000 for each 30-day period for which the failure continued.[48]

A new reporting requirement was added for transfers of property to foreign persons as part of the Deficit Reduction Act of 1984.[49] Section 6038B imposed upon any United States person who (a) transferred property:

i) to a foreign corporation in an exchange described in IRC §§ 332, 351, 354, 355, 356 or 361, or
ii) ii) to a foreign partnership in a contribution under IRC § 721,

or (b) made a distribution in liquidation under IRC § 336 to a person who is not a United States person.[50]

Section 6038B included a civil money penalty for failure to furnish the information. The penalty did not apply if it was due to

[45] Pub. L. 97-248, sec. 339(a).
[46] IRC § 6038A(d)(3).
[47] Pub. L. 100-239, sec. 7403(c).
[48] Pub. L. 115-97, sec. 14401(b)(2).
[49] Pub. L. 98-369.
[50] Pub. L. 98-369, sec. 131(d)(1).

reasonable cause and not willful neglect.[51] Originally, the penalty for failing to comply with IRC § 6038B was 25% of any gain realized on the exchange. In 1997, the penalty provision was amended to make the penalty equal to 10% of the fair market value of the property at the time of the exchange and, in the case of a contribution to a partnership, the United States person was to recognize gain as if the contributed property had been sold.[52]

The Omnibus Budget Reconciliation Act of 1990 added a separate reporting requirement for foreign corporations engaged in business in the United States.[53] The new provision requires foreign corporations engaged in business in the United States to provide information and maintain records similar to those required by IRC § 6038A and such additional information as required by the Secretary.[54] The penalty provisions of 6038A apply to a failure to comply with IRC § 6038C.[55]

The 1996 Small Business Job Protection Act added a new reporting requirement for United States persons who received during any taxable year foreign gifts with an aggregate value exceeding $10,000.[56] Failure to comply with this provision results in (a) the Secretary determining the tax consequences of the gift and (b) a monetary penalty equal to 5% of the amount of the foreign gifts for each month during which the failure continues, not to exceed 25% of the aggregate amount of the gifts.[57] These provisions did not apply if the failure was due to reasonable cause and not willful neglect.[58]

Finally, as part of the Hiring Incentives to Restore Employment Act of 2010, Congress added IRC § 6038D to the Code.[59] The section requires any individual who held "specified foreign financial assets" having an aggregate value exceeding a threshold amount to attach to the person's income tax return a report containing specified information.[60] A penalty of $10,000 was imposed for failure to comply with the reporting requirements of IRC § 6038D, with a continuation penalty of $10,000 for each 30-day

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[51] IRC § 6038B(c)(2).
[52] Pub. L. 105-34, sec. 6011(g).
[53] Pub. L. 101-508, sec. 11315(c).
[54] IRC § 6038C(b).
[55] IRC § 6038C(c).
[56] Pub. L. 104-188, sec. 1905(a).
[57] IRC § 6039F(c)(1).
[58] IRC § 6039F(c)(2)
[59] Publ L. 111-147, sec. 511(a).
[60] IRC § 6038D(a), (b), (c).

period if the information was not furnished within 90 days after the mailing of notice for a maximum continuation penalty of $50,000.[61] Neither the initial penalty nor the continuation penalty applies if the failure to provide the required information was due to reasonable cause and not willful neglect.[62] That a foreign jurisdiction would impose civil or criminal penalties for disclosing the information was not reasonable cause.[63]

D. Failure to File Foreign Information Reporting Penalties Extends the Statute of Limitations on Assessment and Can Result in Increased Deficiencies and Increased Accuracy Penalties.

Aside from being subjected to the penalties discussed in Parts I B and C, above, a taxpayer who fails to file foreign information returns can face additional severe tax consequences. Where any information required to be reported under IRC §§ 6038, 6038A, 6038B, 6038D, 6046, 6046A or 6048 is not reported, the statute of limitations on assessment of tax with respect to any return, event or period such information relates to does not expire until at least three years after the information is reported to the Secretary.[64] Where the failure is due to reasonable cause and not willful neglect, the statute of limitation is extended only with respect to the item(s) related to the failure.[65]

A taxpayer who fails to report a foreign financial asset required under IRC §§ 6038, 6038B, 6038D, 6046A or 6048 is also subject to an increased accuracy penalty of 40% of any understatement of tax which is attributable to the unreported foreign financial asset.[66]

A taxpayer who fails to file a foreign information report under IRC §§ 6038, 6038A, 6038B, 6038D, 6046A or 6048 can face substantial deficiencies arising out of the failure to report. A taxpayer who fails to provide required information under IRC § 6038 with respect to a foreign corporation can result in a reduction of the foreign tax credit claimed with respect to the foreign corporation.[67]

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[61] IRC § 6038D(d).
[62] IRC § 6038D(g).
[63] IRC § 6038D(g).
[64] IRC § 6501(c)(8)(A).
[65] IRC § 6501(c)(8)(B).
[66] IRC § 6662(j).
[67] IRC § 6038(c).

A taxpayer who fails to report a contribution to a foreign partnership that is required under IRC § 6038B is subject to both a penalty equal to 10% of the fair market value of the property contributed and is required to recognize gain as if the property was sold for fair market value.[68]

The taxpayer, nevertheless, may be subject to a penalty under IRC § 6038D and a deficiency based on the unreported gain.

The reduction in foreign tax credit under IRC § 6038(c) and the recognition of gain under IRC § 6038B(c)(1) would both result in underpayments of tax that could lead to notices deficiency and deficiency proceedings in Tax Court.[69]

Although in each of these instances the failure to provide required information on a foreign information report results in both a penalty and an understatement of tax, because the IRS treats the foreign information reporting penalties as "assessable penalties," it does not issue deficiency notices with respect to these penalties. A taxpayer is thus forced to litigate liability for the penalty issue in a separate proceeding from that in which the tax liability is litigated.

II. LACKING STATUTORY AUTHORITY, THE SECRETARY CANNOT ASSESS OR ADMINISTRATIVELY COLLECT PENALTIES UNDER PART III A OF CHAPTER 61A.

In *National Federation of Independent Businesses v. Sebelius*,[70] the Supreme Court upheld the Affordable Care Act ("ACA"). To reach the merits, the Court had to clear the hurdle of the prohibition against injunctive relief in tax cases contained in the Anti-Injunction Act[71] ("AIA"). It did so by noting that unlike the penalties in Chapters 68A and B, the ACA individual mandate penalty is not designated a tax, even though it was to be assessed and collected like a tax. Since the AIA only applies to a "tax," it did not apply to the ACA penalty.

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[68] IRC § 6038B(c)(1).

[69] For an in-depth discussion of the intertwined relationship between foreign information reporting penalties and deficiencies see Frank Agostino and Phillip Colosanto, Jr., "The International Information Reporting Penalties: Is the IRS's Failure to Embrace a One-Stop Shopping Paradigm Inefficient and Statutorily Deficient?," *The Agostino & Associates Journal of Tax Controversy*, November 2018.

[70] 567 U.S. 519 (2102).

[71] IRC § 7421.

The Declaratory Judgment Act[72] ("DJA") prohibits suits for declaratory relief concerning "Federal taxes." Since its reach is co-terminus with that of the AIA,[73] under *Sebelius* the DJA would not bar a court from granting declaratory relief with respect to a penalty that is not deemed a "tax" under the Internal Revenue Code.

Like the individual mandate penalty of the ACA, no provision of the Internal Revenue Code states that the foreign information reporting penalties contained in Chapter 61A IIIA are deemed a tax. Moreover, unlike the ACA individual mandate penalty, there is no provision in the Internal Revenue Code stating that the penalties contained in subchapter A III A of Chapter 61 are assessed and collected like a tax. Several commentators have noted this fact and questioned whether these penalties can be assessed by the IRS.[74]

In *Sibelius* and its companion cases, the Government originally argued that the AIA barred any challenge to the penalty provisions, since they were contained in the Internal Revenue Code and, thus, a tax. In its main brief before the Supreme Court, the Government abandoned that position, stating:

> In this respect, the employer responsibility provision is distinct from the minimum coverage provision, 26 U.S.C.A. 5000A, which consistently refers to the exaction it imposes for failure to maintain minimum essential coverage as a "penalty." Because only certain "penalties" are deemed "taxes" for purposes of the Anti-Injunction Act, the federal government has argued that pre-enforcement challenges to the minimum coverage provision are not barred. See Fed. Gov't Supplemental Br. at 2-9, *Liberty University, Inc. v. Geithner*, No. 10-2347, 2011 WL 3962915 (4th Cir. Sept. 8, 2011), petition for cert. pending, No. 11-438 (filed Oct. 7, 2011); accord *Liberty University*, 2011 WL 3962915, at *24 (Davis, J., dissenting);

[72] 28 U.S.C. § 2201.

[73] *Florida Bankers Assoc. v. Dept. of Treas*., 799 F.3d 1065 (D.C. Cir. 2015) (Kavanaugh, J.).

[74] Erin Collins and Garrett Hahn, "Foreign Information Reporting Penalties: Assessable or Not?," *Tax Notes*, vol. 160, No. 2, p. 211 (July 9, 2018); Frank Agostino and Phillip Colosanto, Jr., "The International Information Reporting Penalties: Is the IRS's Failure to Embrace a One-Stop Shopping Paradigm Inefficient and Statutorily Deficient?," *The Agostino & Associates Journal of Tax Controversy*, November 2018, p.1; Robert Horwitz, "Can the IRS Assess or Collect Foreign Information Reporting Penalties?," *Tax Notes*, vol. 162, No. 3, p. 301 (January 21, 2019).

> *Thomas More Law Ctr. v. Obama*, 651 F.3d 529, 539-540 (6th Cir. 2011), petition for cert. pending, No. 11-117 (filed July 26, 2011). That analysis is inapposite here, given that Congress expressly referred to the "assessable payment" in the employer responsibility provision as a "tax." 26 U.S.C.A. 4980H(b)(2) and (c)(7). Accordingly, the federal government believes that the Fourth Circuit erred when it concluded that the Anti-Injunction Act bars pre-enforcement challenges to the minimum coverage provision, but correctly determined that it bars pre-enforcement challenges to the employer responsibility provision. See *Liberty University*, 2011 WL 3962915, at *4-*14.

A group of legal scholars filed an amicus brief arguing that the AIA barred the courts from hearing the case. The Supreme Court disagreed.[75]

> We think the Government has the better reading. As it observes, “Assessment” and “Collection” are chapters of the Internal Revenue Code providing the Secretary authority to assess and collect taxes, and generally specifying the means by which he shall do so. See §6201 (assessment authority); §6301 (collection authority). Section 5000A(g)(1)’s command that the penalty be “assessed and collected in the same manner” as taxes is best read as referring to those chapters and giving the Secretary the same authority and guidance with respect to the penalty. That interpretation is consistent with the remainder of §5000A(g), which instructs the Secretary on the tools he may use to collect the penalty. See §5000A(g)(2)(A) (barring criminal prosecutions); §5000A(g)(2)(B) (prohibiting the Secretary from using notices of lien and levies). The Anti-Injunction Act, by contrast, says nothing about the procedures to be used in assessing and collecting taxes.
>
> Amicus argues in the alternative that a different section of the Internal Revenue Code requires courts to treat the penalty as a tax under the Anti-Injunction Act. Section 6201(a) authorizes the Secretary to make “assessments of all taxes (including interest, additional amounts, additions to the tax, and assessable penalties).”

[75] 567 U.S. at 545-546.

> (Emphasis added.) Amicus contends that the penalty must be a tax, because it is an assessable penalty and §6201(a) says that taxes include assessable penalties.
>
> That argument has force only if §6201(a) is read in isolation. The Code contains many provisions treating taxes and assessable penalties as distinct terms. See, e.g., §§860(h)(1), 6324A(a), 6601(e)(1)–(2), 6602, 7122(b). There would, for example, be no need for §6671(a) to deem "tax" to refer to certain assessable penalties if the Code already included all such penalties in the term "tax." Indeed, amicus's earlier observation that the Code requires assessable penalties to be assessed and collected "in the same manner as taxes" makes little sense if assessable penalties are themselves taxes. In light of the Code's consistent distinction between the terms "tax" and "assessable penalty," we must accept the Government's interpretation: §6201(a) instructs the Secretary that his authority to assess taxes includes the authority to assess penalties, but it does not equate assessable penalties to taxes for other purposes.
>
> The Affordable Care Act does not require that the penalty for failing to comply with the individual mandate be treated as a tax for purposes of the Anti-Injunction Act. The Anti-Injunction Act therefore does not apply to this suit, and we may proceed to the merits.

Based on the Supreme Court's reasoning in *Sebelius*, since none of the penalties in Part A III of Chapter 61A are deemed to be a "tax," neither the AIA nor the DJA would bar a lawsuit for injunctive or declaratory relief concerning a taxpayer's liability for any of these penalties.

The Supreme Court noted in *Sebelius* that because IRC § 5000A(g)(1) provided that the individual mandate penalty is to be paid upon notice and demand from the IRS and is to be assessed and collected in the same way as assessable penalties under Chapter 68B, it was to be assessed and collected in the same manner as a tax. As discussed above, nothing in the Internal Revenue Code provides that the penalties contained in Part A III of Chapter 61A penalties are to be paid upon notice and demand or are to be assessed and collected in the same manner as a tax. Based upon the Government's argument and the Supreme Court's reasoning in *Sebelius*,

various provisions of the Internal Revenue Code that apply to “tax” should not apply to the foreign information reporting penalties. These include:

- Assessment: IRC § 6201(a) authorizes the IRS “to make inquiries, determinations and assessments of all taxes (including interest, additional amounts, additions to the tax, and assessable penalties) imposed by this title.” IRC § 6202 authorizes the IRS to issue regulations to establish the mode and time for the “assessment of any internal revenue tax (including interest, additional amounts, additions to the tax and assessable penalties).” The only penalties referred to in the Internal Revenue Code as “assessable penalties” are those contained in Chapter 68B and the individual mandate penalty of Section 5000A. Since foreign information reporting penalties under Part A III of Chapter 61A are not a tax, interest, additions to tax or assessable penalties, the IRS has no statutory authority to assess these penalties. Even if the Chapter 61 penalties were a subset the class “additional amounts, additions to tax and assessable penalties,” the Secretary has not promulgated any regulations on the mode and time of their assessment.

- Interest: Under IRC § 6601, a taxpayer has to pay interest on “any amount of tax imposed by this title” that is not paid by the due date. Since the penalties in Part A III of Chapter 61A are not “tax,” the IRS cannot assess interest for unpaid penalties.

- Liens: The federal tax lien imposed by IRC § 6321 arises only when a person “liable to pay any tax neglects or refuses to pay the same after demand.” Since foreign information reporting penalties under Chapter 61A are not a “tax,” there is no automatic lien arising due to a person’s failure to pay such a penalty. Since no lien arises, the IRS cannot legally file a notice of federal tax lien concerning such a penalty.

- Levy: The IRS is empowered to levy against assets of any person “liable to pay any tax [who] neglects or refuses to pay the same….” Since foreign reporting penalties under Chapter 61A are not a “tax,” the IRS cannot use its levy powers to collect them.

- Collection Due Process Proceedings: Sections. 6320 and 6330 require the IRS to afford a "collection due process" hearing when it files a lien against a taxpayer or before it can levy against a taxpayer's assets. Since there is no lien or authority to levy to collect Chapter 61 penalties, these provisions would not apply.

- Statutes of Limitation: The statute of limitations on assessment and collection apply to "any tax."[76] Since the Chapter 61 penalties are not a "tax," these statutes of limitation would not apply.

The Internal Revenue Manual states that all foreign information reporting penalties, including those contained in Chapter 61A, are "assessable penalties" that are assessed without issuance of a 30-day letter or prior notice requirements and are to be paid upon notice and demand.[77] As a result, the IRS will continue to file notices of federal tax lien and use its levy power to collect these taxes.

While the provisions of the Internal Revenue Code listed above do not appear to apply to the foreign reporting penalties imposed by Part A III of Chapter 61A, several procedural provisions of the Code do apply. First, the IRS can conduct investigations and issue summonses for, among other things, "the purpose of ascertaining the correctness of any return, [and] making a return where none has been made…."[78] This would apply to foreign information reports, which are information returns. Second, a claim for refund must be filed before a taxpayer can sue for refund of any tax or "any penalty claimed to have been collected without authority...."[79] Thus, the refund provisions apply to penalties under Part III A of Chapter 61 A.

If the IRS cannot assess and administratively collect the tax, a foreign information reporting penalty contained in Part III A of Chapter 61 A can only be collected by authorizing the Department of Justice to file a lawsuit to collect the penalty. Because the Internal Revenue Code does not contain a statute of limitation for these penalties, the period for suing to collect would be governed by 28 U.S.C. § 1658:

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[76] IRC §§ 6501(a), 6502(a).
[77] Internal Revenue Manual ¶20.1.9.1.1.2 (10-24-2013).
[78] IRC § 7602(a).
[79] IRC § 7422.

(a) Except as otherwise provided by law, a civil action arising under an Act of Congress enacted after the date of the enactment of this section may not be commenced later than 4 years after the cause of action accrues.

Since the liability for the penalty would arise when a taxpayer fails to file a required report, the cause of action would accrue on the due date of the report. Thus, the Government would have four years after the due date of the return within which to file a suit in district court to collect a foreign information reporting penalty.

III. CONGRESS SHOULD AMEND CHAPTER 61, SUBCHAPTER A, PART IIIA TO INCLUDE PROVISIONS SIMILAR TO THOSE CONTAINED SECTIONS 6665 AND 6671 IN PART III A OF CHAPTER 61A AND SECTIONS 6677 AND 6679.

In our view, two problems arise out of the current statutory scheme. First, the Secretary appears to have no statutory authority to assess or administratively collect the penalties imposed in Part III A of Chapter 61A. Second, even if he does have such authority, because the IRS treats these penalties as assessable penalties, a taxpayer and the Government would have to litigate the merits of the penalty and any related deficiency in separate legal proceedings.

We propose that Congress enact legislation to fix both problems. To do so would require a) enacting a new IRC § 6040 to Part III A of Chapter 61 A and to renumber current IRC § 6040 as IRC § 6041 and b) amending IRC §§ 6677 and 6679 to allow for deficiency proceedings in certain instances. The proposed IRC § 6040 would provide as follows:

IRC § 6040. Rules Applicable to Penalties

(a) Penalties Treated as Tax: Except as otherwise provided in this title—

(1) the penalties provided by this chapter shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes; and

(2) any reference in this title to "tax" imposed by this title shall be deemed also to refer to the penalties provided by this chapter.

(b) Procedure for Assessing Certain Penalties: For purposes of subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes), subsection (a) shall apply only if the Secretary determines a deficiency with respect to the period for which the information was not provided.

Sections 6677(d) and 6679(b) will be amended from "Deficiency procedures not to apply: Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed by subsection (a)" to read as follows:

Application of Deficiency Procedures: For purposes of subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes), subsection (a) shall apply only if the Secretary determines a deficiency with respect to the period for which the information was not provided.

Enactment of the proposed provisions will ensure that the Secretary in fact has statutory authority to assess and administratively collect foreign information reporting penalties. It will also provide a means for a taxpayer against whom such penalties are asserted the right to challenge the proposed penalties in deficiency procedures if the Secretary determines a deficiency in tax for the period with respect to which the penalty is asserted. This change would also further the objectives of fairness, efficiency and judicial economy.