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**PROPOSED CHANGES TO JUDICIAL JURISDICTION FOR
ASSESSABLE PENALTIES AND FOREIGN INFORMATION PENALTIES**

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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 or its Taxation Section.

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EXECUTIVE SUMMARY

Currently, civil tax penalties are assessed using one of two methods. On the one hand, there are penalties that are assessed in conjunction with the underlying tax and are subject to deficiency procedures, thus, such penalties cannot be assessed until a Notice of Deficiency (“NOD”) is issued. On the other hand, there are other penalties that are assessed immediately without a right to pre-assessment judicial review.

The penalties subject to deficiency procedures, such as the accuracy penalty under IRC § 6662 or the fraud penalty under IRC § 6663, give the taxpayer the opportunity for pre-assessment review of the penalty by the Tax Court. Assessment and collection are then postponed until the decision of the Tax Court becomes final. Other penalties, such as those found under Code’s Chapter 61A (e.g., IRC §§ 6038, 6038A, 6038(B), etc.) and Chapter 68B (e.g., IRC § 6707A), are assessed without the taxpayer being afforded the right to challenge the penalty in court before assessment. Penalties for violations of foreign information reporting are included in this list.

To challenge these other penalties in court, the taxpayer must first pay the penalty in full and file a refund claim. Not until the refund claim has been denied or six months has passed, can the taxpayer file a refund suit in U.S. District Court or U.S. Court for Federal Claims to challenge these penalties. As a direct result of the absence of pre-assessment and pre-collection judicial review for these select penalties, particularly as to the foreign information reporting penalties and Chapter 68 assessable penalties, a clear inequity and financial hardship persists as a direct result of the disparate treatment of such penalties.

This paper advocates for a unified deficiency procedure for all penalties and suggests that Congress amend the Internal Revenue Code (the “Code” also referred to as “IRC”) to make the deficiency procedures apply to foreign information reporting penalties in Chapter 61A and assessable penalties in Chapter 68B. A unified procedure eliminates the need to distinguish between penalties that are subject to deficiency procedures and those that are not, allowing for pre-assessment judicial review by the Tax Court, and ensuring all taxpayers’ due process rights.

DISCUSSION

I. INTRODUCTION: WHY UNIFIED APPLICATION OF DEFICIENCY PROCEDURES IS NEEDED

Since 2018, tax practitioners have pointed out serious issues regarding the Commissioner's powers to assess and collect foreign information reporting penalties under Chapter 61A without having the requisite statutory authority.³ As these issues persist, affected taxpayers have endured the inequity and financial hardship arising from often draconian penalties under Chapter 61A and Chapter 68B being assessed without prior judicial review. The Commissioner assesses these penalties immediately because they are not subject to deficiency procedures—procedures that allow taxpayers to obtain Tax Court review prior to assessment. Unifying all penalties under one deficiency regime will bring taxpayers' hardship to an end.

A. General Process of Assessment

IRC § 6201(a) authorizes the Secretary of the Treasury to assess all taxes and lists assessable penalties as part of the term “taxes” in parenthesis. Accordingly, the Secretary is authorized to assess “assessable penalties,” which the Secretary delegated to the Commissioner of Internal Revenue, who has delegated to the Internal Revenue Service (“IRS”) officials.⁴

An “assessment” is “the formal recording of a taxpayer's tax liability” on the Commissioner's records.⁵ An assessment is a critical event in the life of a tax liability—for the taxpayer, the Commissioner, and the administration of the tax system. The most common assessment results from filing a tax return reflecting a tax due, commonly called a “self-assessment” or a “summary assessment.”⁶ Other types of assessments are deficiency assessments, jeopardy assessments, and termination assessments. The general rule is a tax may not be collected until it has been assessed and must be assessed within three years of filing the return.⁷

Once made, an assessment is presumed correct (with certain exceptions) in any later litigation where the merits of the tax may be challenged. For collection purposes, unless judicially determined otherwise, the assessment has, in effect, the force and effect of a judgment. The assessment procedures are found in Chapter 63 of the Code, and include general assessment procedures (Subchapter A), deficiency procedures for income, estate, gift, and certain excise taxes (Subchapter B), and the tax treatment of partnership items under TEFRA and BBA (Subchapters C and D).

³ See Erin Collins and Garrett Hahn, Foreign Information Reporting Penalties: Assessable or Not? TAX NOTES TODAY (July 9, 2018) 211-213; Robert Horwitz, Can the IRS Assess or Collect Foreign Information Reporting Penalties? TAX NOTES TODAY (Jan. 31, 2019) 301-305; Frank Agostino and Phillip Colasanto, The IRS's Illegal Assessment of International Penalties, TAX NOTES TODAY (Apr. 8, 2019) 261-269.

⁴ See Treas. Reg. §§ 301.6201-1(a), 301.7601-1, and 301.7701-9.

⁵ *Baltic v. Commissioner*, 129 T.C. 178, 183 (2007).

⁶ Section 6201 authorizes the Secretary to assess all taxes reported by a taxpayer on his return. *Richmond v. Commissioner*, T.C. Memo. 2005-238.

⁷ IRC § 6501(a).

Most taxes are assessed using summary assessment in which the Commissioner may immediately “assess” the tax determined by the taxpayer on his or her return.⁸ The summary assessment is not subject to pre-assessment judicial review unless the IRS determines that the taxpayer has understated his tax liability. When an understatement of tax liability occurs, the IRS will issue a notice of deficiency (“NOD”).⁹

If after receiving a NOD, the taxpayer files a timely petition in the Tax Court, the Commissioner is restricted from assessing the deficiency “until the decision of the Tax Court has become final.”¹⁰ In such a deficiency proceeding the Tax Court has jurisdiction to “redetermine the correct amount of the deficiency . . . and to determine whether any additional amount, or any addition to the tax should be assessed.”¹¹ Some civil tax penalties imposed by the Code are subject to the deficiency procedures, such as IRC §§ 6662 and 6663, requiring the Commissioner to assert such penalties in an NOD (or in an answer to a Tax Court petition) before those penalties can be assessed.¹²

B. Assessments Not Subject to Deficiency Procedures – “Assessable Penalties”

Penalties not subject to deficiency procedures generally fall into two categories: so-called “assessable” penalties¹³ (*i.e.*, Chapter 68B of the Code) and certain foreign information reporting penalties (*i.e.*, Chapter 61A of the Code). Many of these penalties do not relate to a tax deficiency but penalize the violation of a reporting requirement and can be imposed whether or not there is a tax deficiency. The vast majority of civil tax penalties are assessed without a right to pre-assessment judicial review.¹⁴

Assessable penalties (e.g., IRC §§ 6671 – 6725) can be immediately assessed without first issuing an NOD.¹⁵ Additionally, the following Chapter 68A penalties are also not subject to deficiency procedures: failure to file a return or pay tax (IRC § 6651); an individual’s failure to pay estimated income tax (IRC § 6654); and a corporation’s failure to pay estimated tax (IRC § 6655(b)).¹⁶

The foreign information reporting penalties, notably, are not governed by an assessment authority provided in the Code. The Code states that various penalties, such as Chapter

⁸ IRC § 6201(a)(1); *Meyer v. Commissioner*, 97 T.C. 555, 559–60 (1991).

⁹ IRC § 6212(a).

¹⁰ IRC § 6213(a).

¹¹ IRC § 6214(a).

¹² See IRC § 6665(a).

¹³ These “assessable” penalties are generally those that are due and payable upon notice and demand. Unlike penalties subject to deficiency procedures, assessable penalties carry no rights to a 30-day letter, agreement form, or notice requirements prior to assessment. Internal Revenue Manual (“IRM”) 20.1.9.1.5, Common Terms and Acronyms (Jan. 29, 2021).

¹⁴ See, for example, *Graev v. Commissioner*, 149 T.C. 485, 517-19. (2017) (Holmes, J., concurring in result) (noting that the Code’s deficiency procedures applied to only 7.22% of the total amount of civil tax penalties assessed between October 2015 and September 2016).

¹⁵ IRC §§ 6201(a) and 6671(a).

¹⁶ *Williams v. Commissioner*, 131 T.C. 54, 58 n.4 (2008).

68 penalties, are assessed and collected in the same manner as a tax.¹⁷ However, penalties imposed under IRC §§6038(b), 6038A, 6038B, 6038C, 6038D, 6039F(c), 6046, and 6048, are neither classified by the Code as penalties subject to deficiency procedures nor as assessable penalties.

Recently, the Tax Court prevented the Commissioner from collection of unpaid penalties assessed against a taxpayer under IRC §§ 6038(b)(1), (2) because the Commissioner assessed the penalties “without statutory authority to do so.”¹⁸ The Tax Court determined, among other things, that Congress did not grant the Secretary assessment and collection power for penalties asserted under IRC § 6038, the term “assessable penalties” in IRC § 6201(a) did not “automatically apply to *all* penalties in the Code not subject to deficiency procedures,” and the term “taxes” in IRC § 6201(a) did not encompass the § 6038 penalties given both taxes and assessable penalties are distinct categories governed by specific provisions.¹⁹

Nevertheless, for simplicity, penalties not subject to deficiency procedures shall be referenced herein by the term “assessable penalties.”

C. The Commissioner’s Enforcement Methods to Collect Assessable Penalties Is Inequitable

After an assessment is recorded, if payment is not made, the Commissioner initiates the collection process. The Commissioner can enforce collection of any unpaid part of the assessment by filing a Notice of Federal Tax Lien or by levying on the taxpayer’s property and rights to property.²⁰ These collection enforcement methods can be used against taxpayers if payment is not made after notice and demand for payment.²¹

The only way the taxpayer can obtain judicial review of an assessed tax liability is by adhering to the “full-payment rule.”²² Generally, the “full-payment rule” provides that a taxpayer can file a refund suit in U.S. District Court or the U.S. Court of Federal Claims only after full payment of the entire liability.²³

Unlike a taxpayer who receives a NOD, e.g., “ticket to Tax Court”, and thus, can obtain Tax Court review of the liability prior to assessment and without paying anything toward the proposed liability, a taxpayer who has an assessable penalty cannot obtain judicial review at all unless the total liability is paid first. In turn, taxpayers charged with such assessable penalties are immediately subjected to the Commissioner’s enforcement methods while taxpayers with NODs have a right to judicially challenge the correctness of such penalties before the Commissioner may enforcement payment. This disparity perpetuates inequity and financial

¹⁷ IRC §§ 6665(a) (additions to tax, additional amounts and penalties under Ch. 68B) and 6671(a) (penalties under Ch. 68B).

¹⁸ *Farhy v. Commissioner*, 160 T.C. No. 6 (April 3, 2023).

¹⁹ *Id.*

²⁰ IRC §§ 6665(a), 6321–6327 (lien), 6331–6344 (levy); see *Galletti*, 541 U.S. at 122.

²¹ IRC § 6321. Under IRC § 6331(a), the IRS can levy against the taxpayer’s property if payment is not made within ten days after notice and demand.

²² *Flora v. United States*, 362 U.S. 145, 177 (1960).

²³ See 28 U.S.C. §§ 1346(a), 1491(a)(1); Code § 7422; *Flora v. United States*, 362 U.S. 145, 177 (1960); *Interior Glass Systems v. United States*, 927 F.3d 1081, 1086 (9th Cir. 2019).

hardship entirely independent of the ultimate legitimacy in substance or amount of these penalties in contrast to the penalties that require a NOD.

II. INEQUITY AND FINANCIAL HARDSHIP ON TAXPAYERS WITH ASSESSABLE PENALTY LIABILITY

A. The Full-Payment Rule Applies to Most Taxpayers

To obtain any chance at removing an assessable penalty, a taxpayer has very limited options other than to first pay the penalty in full. As mentioned briefly above, a taxpayer may sue to recover “any sum” that the taxpayer believes has been erroneously assessed or collected.²⁴ However, until a taxpayer has paid the assessment in full, including penalties and interest where those items are also in dispute,²⁵ the taxpayer is generally not able to obtain judicial review.²⁶ Only after full payment can the taxpayer file a refund claim and, if rejected, file a refund suit to obtain judicial review.

Only in rare circumstances may a taxpayer obtain judicial review without full payment of the liability. For example, if an assessment may be “divisible into a tax on each transaction or event,” the taxpayer need only pay an amount sufficient to cover one of those transactions prior to filing a claim for refund and, subsequently, a refund suit. One example of a “divisible” tax is the trust fund recovery penalty under IRC § 6672(a)—a collection device that makes all “responsible persons” jointly and severally liable for a business’s unpaid trust fund taxes. IRC § 6331(i) provides that (despite IRC § 7421), if a taxpayer pays part of a “divisible” tax and files a proper suit for refund, the IRS generally cannot levy to collect the unpaid divisible tax during the suit’s pendency. Other exceptions to the “full-payment rule” include those who have paid 15 percent of certain assessable preparer penalties under IRC §§ 6694(c), IRC §§ 6700 (promoting abusive tax shelters) and 6701 (aiding and abetting understatements).

Additionally, without regard to how much of the liability has been paid, IRC § 7422(j) provides that the U.S. District Courts and the U.S. Court of Federal Claims “shall not fail to have jurisdiction” to determine the “estate tax liability of such estate (or for any refund with respect thereto) solely because the full amount of such liability has not been paid by reason of an election under section 6166” to pay the liability in installments.

²⁴ *Flora v. United States*, 362 U.S. 145, 177 (1960).

²⁵ It is noted that Courts have differed on whether jurisdiction may be obtained by paying only the assessed tax, without penalties and interest, if one is only challenging the tax (*c.f. Shore v. United States*, 9 F.3d 1524 (Fed. Cir. 1993) (holding full payment rule did not require full payment of penalties/interest if those items were not disputed) and *Magnone v. United States*, 902 F.2d 192 (2nd Cir. 1990) (holding that full payment rule required payment of assessment, penalties, and interest)).

²⁶ *Id.* Under IRC § 6330(c)(2)(B), a taxpayer in a collection due process proceeding can challenge the underlying liability if he did not receive an NOD “or otherwise have an opportunity to dispute such tax liability.” The courts have held that a right to appeal a proposed penalty assessment to the IRS Independent Office of Appeals is “an opportunity to dispute such tax liability.” See, *Keller Tank Services, Inc. v. Commissioner*, 854 F.3d 1178 (10th Cir. 2017); *Our Country Home Ent., Inc. v. Commissioner*, 855 F.3d 773 (7th Cir. 2017). Because the IRS generally affords a taxpayer a right to appeal a penalty under Ch. 61A or Ch. 68B prior to issuing a CDP notice, a taxpayer against whom such penalties are assessed will rarely have an opportunity to challenge the assessment pre-payment in a collection due process proceeding.

The above reflects that in addition to penalties that are proposed in conjunction with NODs, there are exceptions that afford taxpayers an early opportunity to obtain judicial review, suggesting that it is within reason for taxpayers with assessable penalties should also be afforded such beneficial due process.

Taxpayers frequently obtain relief from assessable penalties that are assessed systematically (as opposed to manual assessment during audit) upon request of an abatement based on reasonable cause or a conference with the IRS Independent Office of Appeals.²⁷ National Taxpayer Advocate has previously reported that the IRS abated between 71 percent and 88 percent of dollars systemically assessed under IRC §§ 6038 and 6038A.²⁸ But this abatement is not distributed equally.

III. RESOLUTION: MAKING DEFICIENCY PROCEDURES APPLY TO PENALTIES UNDER CHAPTERS 61A AND 68B

Enacting legislation to make all penalties under Chapters 61A and 68B subject to deficiency procedures would put an end to the inequitable burden bestowed upon taxpayers with assessable penalties. These changes provide more equitable access to judicial review and reinforce the taxpayer's due process rights.

For example, amending IRC § 6212 to require the IRS to issue a notice of deficiency before assessing penalties under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D or to expand the deficiency process to cover all penalties in Chapter 61A and 68B would allow taxpayers to obtain judicial review by the Tax Court before they are assessed.

Additionally, IRC § 6671 should be amended to provide that penalties in Chapters 61A and 68B are both deemed to be a tax, assessed and collected like a tax, and that deficiency procedures shall apply. The language to effectuate this amendment could read “the deficiency procedures of subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall apply to any penalty described in this subchapter and in subchapter A of Chapter 61.”

A unified deficiency procedure eliminates the need to distinguish between assessable and nonassessable penalties, removing procedural web used to assess taxes and penalties and improving tax administration. Because applying the deficiency procedures to assessable penalties provides a clear and unified procedure for all penalty assessments, this unified approach would provide more equitable access for taxpayers to obtain judicial review of adverse IRS determinations.

²⁷ See National Taxpayer Advocate 2020 Annual Report to Congress 119, 124-125 (Most Serious Problem: International: The IRS's Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS) (reporting that when penalties under IRC §§ 6038 and 6038A are applied systemically, the abatement percentage, measured by number of penalties, ranges from 55 to 72 percent, and by dollar value of penalties ranges from 71 to 88 percent). The IRS abates manual assessments at rates ranging from 17 percent to about 39 percent by number, and from eight percent to about 66 percent by dollar.

²⁸ *Id.*

IV. CONCLUSION

In sum, for taxpayers with assessable penalties, and with particularity as to the foreign information reporting penalties, the Code operates to provide judicial review only to those who can afford to pay in full the assessment plus interest. To protect taxpayers' due process rights, unified application of the deficiency procedure to all penalties under Chapters 61A and 68B would provide a means for all taxpayers to challenge erroneous assessments and collections regardless of wealth or status.