Can the IRS Assess or Collect Foreign Information Reporting Penalties?

by Robert S. Horwitz

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In this article, Horwitz argues that the foreign information reporting penalties under chapter 61 of the code are not a tax and can't be assessed and collected in the same manner as a tax.

In *National Federation of Independent Business* (*NFIB*),[1] the Supreme Court upheld the Affordable Care Act. To reach the merits, the Court had to clear the hurdle of the prohibition against injunctive relief in tax cases under the Anti-Injunction Act.[2] It did so by noting that unlike the penalties in subchapters 68A and 68B of the code, the ACA individual mandate penalty is not designated a tax. Thus, it was not a tax, even though it was to be assessed and collected like a tax. Because the Anti-Injunction Act applies only to a tax, it did not apply to the ACA penalty.

The Declaratory Judgment Act prohibits suits for declaratory relief concerning "Federal taxes."[3] Because its reach is coterminous with that of the Anti-Injunction Act,[4] under *NFIB* the Declaratory Judgment Act would not bar a court from granting declaratory relief regarding a penalty that is not deemed a tax in the code.

Several years ago, I noticed that like the ACA penalty, the foreign information reporting penalty of section 6038 was not deemed a tax, but unlike the ACA individual mandate penalty, there was no provision that it was to be assessed and collected like a tax.

On July 9, 2018, *Tax Notes* published an article by Erin Collins and Garrett Hahn arguing that the IRS could not assess foreign reporting penalties (despite IRS claims to the contrary).[5] In November 2018 Frank Agostino and Phillip J. Colasanto published an article on the possible lack of assessment authority for foreign reporting penalties and whether those penalties should be subject to deficiency procedures.[6] Those articles spurred me to look again at the foreign information reporting penalties.

I conclude that because the foreign reporting penalties in chapter 61 are not a tax and are not assessed and collected in the same way as a tax, an action for declaratory or injunctive relief concerning an asserted penalty is not barred. Further, because these penalties are not deemed a tax and are not assessed and collected as a tax, (1) the IRS is not authorized to assess them; (2) the IRS cannot file tax liens or levy against assets to collect them; and (3) the collection due process provisions do not apply. And because interest runs only on an unpaid tax, the IRS is not entitled to interest on a foreign reporting penalty. The only way the IRS can collect the penalty is to authorize

[1] *National Federation of Independent Business v. Sebelius*, 567 U.S. 519 (2012).

[2] Section 7421.

[3] 28 U.S.C. section 2201.

[4] *Florida Bankers Association v. Department of Treasury*, 799 F.3d 1065 (D.C. Cir. 2015) (Kavanaugh, J.).

[5] Collins and Hahn, "Foreign Information Reporting Penalties: Assessable or Not?" *Tax Notes*, July 9, 2018, p. 211.

[6] Agostino and Colasanto, "The International Information Reporting Penalties: Is the IRS's Failure to Embrace a One-Stop Shopping Paradigm Inefficient and Statutorily Deficient?" Agostino & Associates (Nov. 2018).

the Justice Department to file a lawsuit against the taxpayer, but this must be done within five years of when the liability accrues — that is, within five years of the due date of the return.

The Statutory Provisions

Chapter 61 of the code contains various reporting requirements, including for reporting foreign information. Many of the sections under that chapter impose penalties for failure to comply with the reporting requirements. Section 6038 requires taxpayers to provide specific information on controlled foreign corporations and partnerships. Subparagraph (b) states:

> (b) Dollar penalty for failure to furnish information
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> (1) In general: If any person fails to furnish, within the time prescribed under paragraph (2) of subsection (a), any information with respect to any foreign business entity required under paragraph (1) of subsection (a), such person shall pay a penalty of $10,000 for each annual accounting period with respect to which such failure exists.
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> (2) Increase in penalty where failure continues after notification: If any failure described in paragraph (1) continues for more than 90 days after the day on which the Secretary mails notice of such failure to the United States person, such person shall pay a penalty (in addition to the amount required under paragraph (1)) of $10,000 for each 30-day period (or fraction thereof) during which such failure continues with respect to any annual accounting period after the expiration of such 90-day period. The increase in any penalty under this paragraph shall not exceed $50,000.

Other reporting penalties in chapter 61 are in:

- section 6038A (information regarding foreign-owned corporations, with a $25,000 minimum penalty);
- section 6038B (information on transfers to foreign corporations and partnerships, with a penalty equal to 10 percent of the fair market value of the property transferred, up to $100,000 unless the failure was intentional);
- section 6038C (information from foreign corporations conducting business in the United States, with a $25,000 minimum penalty);
- section 6038D (failure to report foreign financial assets, with the same penalty as section 6038(b));
- section 6039E (failure to provide required information concerning resident status, with a penalty of $500);
- section 6039F (failure to provide information concerning foreign gifts, with a minimum penalty equal to 5 percent of the amount of the gift); and
- section 6039G (information concerning expatriation, with a $10,000 penalty).

None of these sections deems the penalty a tax or states that it is to be assessed or collected as a tax. There is no section in chapter 61 providing that the penalties imposed in that chapter are deemed a tax or are to be assessed and collected as a tax. This is in contrast with the penalties in subchapter 68A (additions to tax and additional amounts) and subchapter 68B (assessable penalties). Under sections 6665 and 6671, the penalties and additions to tax in subchapters 68A and 68B, respectively, are to be assessed, collected, and paid in the same manner as taxes, and any reference to "tax" in the code is deemed to refer to those additions and penalties.

Applicability of the Anti-Injunction Act

In *NFIB* and its companion cases, the government originally argued that the Anti-Injunction Act barred any challenge to the penalty provisions because they were contained in the code and were thus a tax. In its main brief before the Supreme Court, the government abandoned that position, stating:

> 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. . . . That analysis is inapposite here, given that Congress

> expressly referred to the "assessable payment" in the employer responsibility provision as a "tax." 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. [Citations omitted.]

A group of legal scholars filed an amicus brief urging that the Anti-Injunction Act barred the courts from hearing the case. The Supreme Court disagreed:

> 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 section 6201 (assessment authority); section 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 section 5000A(g), which instructs the Secretary on the tools he may use to collect the penalty. See section 5000A(g)(2)(A) (barring criminal prosecutions); section 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.
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> 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*)." Amicus contends that the penalty must be a tax, because it is an assessable penalty and section 6201(a) says that taxes include assessable penalties.
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> That argument has force only if section 6201(a) is read in isolation. The Code contains many provisions treating taxes and assessable penalties as distinct terms. See, e.g., sections 860(h)(1), 6324A(a), 6601(e)(1)-(2), 6602, 7122(b). There would, for example, be no need for section 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: section 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.
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> 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.[7] [Emphasis added.]

Based on the Supreme Court's reasoning in *NFIB*, because none of the penalties in chapter 61 is deemed a tax, neither the Anti-Injunction Act nor the Declaratory Judgment Act bars a lawsuit for injunctive or declaratory relief concerning a taxpayer's liability for any of those penalties.

Many IRS Investigation Powers Don't Apply

Based on the Supreme Court's reasoning in *NFIB*, because chapter 61 penalties are not a tax and are not assessed, collected, and paid in the

[7] *NFIB*, 567 U.S. at 545-546.

same manner as a tax, various sections of the code do not apply. These include the following:

- *Assessment*: Section 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 penalty." Section 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)." "Assessable penalties" refers to the penalties imposed by subchapter 68B and penalties that, under the code, are to be assessed and collected as a tax. Because foreign information reporting penalties under chapter 61 are not a tax, interest, additions to tax, or assessable penalties, the IRS cannot assess these penalties.
- *Interest*: Under section 6601, a taxpayer must pay interest on "any amount of tax imposed by this title" that is not paid by the due date. Because the chapter 61 penalties are not a tax, the IRS cannot assess interest for unpaid penalties.
- *Liens*: The federal tax lien imposed by section 6321 arises only when a person "liable to pay any tax neglects or refuses to pay the same after demand." Because chapter 61 penalties are not a tax, a federal tax lien does not arise for failure to pay such a penalty, and a notice of federal tax lien cannot be filed.
- *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." Because foreign reporting penalties are not a tax, the IRS cannot use its levy powers to collect them.
- *CDP*: Sections 6320 and 6330 require the IRS to afford a CDP hearing when it files a lien against a taxpayer or before it can levy against a taxpayer's assets. Because there is no lien or authority to levy to collect chapter 61 penalties, these provisions would not apply.
- *Statutes of limitations*: The statutes of limitations on assessment and collection apply to "any tax."[8] Because the chapter 61 penalties are not a tax, these statutes of limitations would not apply.

As noted in the article by Collins and Hahn, the IRS maintains that it can assess and administratively collect chapter 61 penalties. Because the IRS takes that position, it will continue to issue CDP notices to taxpayers it claims are liable for those penalties. In such cases, the taxpayer can assert that the IRS has no authority to assess, file liens, or levy.

Specific procedural provisions of the code apply to chapter 61 penalties. Because the IRS can conduct investigations and issue summonses for "the purpose of ascertaining the correctness of any return, [and] making a return where none has been made,"[9] it can investigate a failure to file a foreign information report. The taxpayer must file a claim for a refund before suing for a refund, because refund claims are a prerequisite for a suit for refund of any tax or "any penalty claimed to have been collected without authority."[10]

Justice Would Have to Sue to Collect

I agree with Collins and Hahn that the only way the IRS can collect any foreign information reporting penalty is by authorizing the Justice Department to sue to collect it. Because the code does not contain a statute of limitations for these penalties, the period for suing to collect would be that of the catch-all statute of limitations contained in 28 U.S.C. section 2462:

> Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon.

[8] Sections 6501(a) and 6502(a).

[9] Section 7602(a).

[10] Section 7422.

Because 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 associated return. Thus, the government would have five years after the due date of the return within which to file a suit in district court to collect a chapter 61 penalty.

Agostino cogently argues that the foreign information reporting penalties (specifically those under sections 6038, 6038B, and 6038D) are not assessable penalties but relate to forms required to be filed with an income tax return, and thus should be subject to deficiency procedures.

The IRS will probably disagree with everything I say here, and also with Agostino's argument that foreign information reporting penalties should be subject to deficiency procedures. ■