Received
09/09/22 04:55 pm

Filed
09/09/22

Alon Farhy,

Petitioner

v.

Commissioner of Internal Revenue

Respondent

Electronically Filed
Docket No. 10647-21L
Document No. 23

Simultaneous Opening Brief

SERVED 09/12/22

Received
09/09/22 04:55 pm

Filed
09/09/22

Alon Farhy,

Petitioner

v.

Commissioner of Internal Revenue

Respondent

Electronically Filed
Docket No. 10647-21L
Document No. 23

Simultaneous Opening Brief

UNITED STATES TAX COURT

ALON FARHY, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	))))))))))	Docket No. 10647-21L Filed Electronically Judge L. Paige Marvel

---

OPENING BRIEF FOR RESPONDENT

DRITA TONUZI
Deputy Chief Counsel (Operations)
Internal Revenue Service

OF COUNSEL:
JOSEPH W. SPIRES
Division Counsel
(Small Business/Self-Employed)
SHERRI SPRADLEY WILDER
Area Counsel
(Small Business/Self-Employed:Area 8)
CHRISTINE A. FUKUSHIMA
Associate Area Counsel
(Small Business/Self-Employed)
CASSIDY B. COLLINS
Senior Counsel
(Small Business/Self-Employed)

CONTENTS

Page

PRELIMINARY STATEMENT 1

QUESTION PRESENTED 3

RESPONDENT'S REQUEST FOR FINDINGS OF FACT 4

I. Background Information 4

II. The IRS's Collection Efforts and Collection Due Process Hearing 4

III. The Section 6038 Penalties 5

ULTIMATE FINDINGS OF FACT 8

POINTS RELIED UPON 9

ARGUMENT 10

I. The Court Need Not Decide Whether the Assessment Authority Issue is a Challenge to Underlying Liability 10

II. The IRS Has Authority and a Duty to Assess Section 6038(b) Penalties Under Section 6201 10

III. Section 6038 Penalties Are Assessable Penalties 13

IV. The IRS, Not the Department of Justice, Has Authority to Collect Section 6038 Penalties Using Its Ordinary Collection Mechanisms 16

CONCLUSION 17

CITATIONS

Page

Cases

Colliot v. United States, No. 1:19-cv-212, 2021 WL 2709676 (W.D. Tx. March 24, 2021) 15

Dewees v. United States, 272 F. Supp. 3d 96 (D.D.C. 2017) 15

Flume v. Commissioner, T.C. Memo. 2017-21 16

Golsen v. Commissioner, 54 T.C. 742 (1970) 14

Grajales v. Commissioner, 156 T.C. 55 (2021) 11

Heydemann v. United States, No. WDQ–07–3362, 2008 WL 2502188 (D. Md. April 23, 2008) 15

Ruesch v. Commissioner, 154 T.C. 289 (2020) 14, 16

Smith v. Commissioner, 133 T.C. 424 (2009) 13

Wheaton v. United States, 888 F.Supp. 622 (D. NJ. 1995) 15

Statutes

I.R.C. § 6038 ..... 1, 3, 4, 5, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 18

I.R.C. § 6038(a) 6, 12

I.R.C. § 6038(b) 10, 11, 12

I.R.C. § 6038(b)(1) 10

I.R.C. § 6038(b)(2) 10

I.R.C. § 6201 ..... 10, 11, 12, 13, 14

I.R.C. § 6201(a) 9, 10, 11, 12, 13, 14, 15, 16

I.R.C. § 6201(a) (1) 9, 12

I.R.C. § 6202 15

I.R.C. § 6320(c) 5

CITATIONS

Page

I.R.C. § 6330(c)(1) 5

I.R.C. § 6501 12

I.R.C. § 6501(c)(8) 15

I.R.C. § 6501(c)(8)(A) 12

I.R.C. § 6663 13

I.R.C. § 6682(c) 14

I.R.C. § 6698(d) 14

I.R.C. § 6699(d) 14

I.R.C. § 6751(b) 7

I.R.C. § 7482(b)(1) 14

Rules

Tax Court Rule 122 2

UNITED STATES TAX COURT

ALON FARHY, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	))))))))))	Docket No. 10647-21L Filed Electronically Judge L. Paige Marvel

---

OPENING BRIEF FOR RESPONDENT

PRELIMINARY STATEMENT

This case is a collection due process case involving petitioner's liabilities for civil penalties for section[1] 6038 penalties for tax years 2003 through 2010. The IRS imposed penalties of $60,000 per year ($10,000 initial penalty and $50,000 continuation penalties) due to petitioner's willful failure to file Forms 5471 for his wholly owned foreign corporations, Katuma Capital Inc. and Morning Star Inc., corporations formed in Belize. The sole issue remaining in dispute is whether the IRS had legal authority to assess section the 6038 penalties; the parties have stipulated that petitioner had a Form 5471 filing requirement, petitioner willfully

---

[1] All section references are to the Internal Revenue Code in effect for the years at issue.

failed to file any Forms 5471, and the IRS met the requirements of any applicable law or administrative procedure related to collection due process hearings.

On May 12, 2022, this case was submitted for decision pursuant to Rule 122, before the Honorable Richard T. Morrison. On August 22, 2022, this case was reassigned to the Honorable L. Paige Marvel. The record in this case consists of a Stipulation of Facts (Stip.) containing paragraphs 1 through 18 and Exhibits (Ex.) 1-J through 14-J.

The Court ordered the parties to file simultaneous opening briefs on or before September 9, 2022, and simultaneous answering briefs on or before November 8, 2022.

Rule 155 computations will not be necessary in this case.

QUESTION PRESENTED

1. Does the Internal Revenue Code grant the IRS legal authority to assess a penalty under section 6038 if a taxpayer has a Form 5471 filing requirement, fails to timely file said Form 5471, and the failure was not attributable to reasonable cause?

RESPONDENT'S REQUEST FOR FINDINGS OF FACT

I. Background Information

1. At the time the Petition was filed, petitioner resided in Tel Aviv, Israel. Stip. ¶ 1.

II. The IRS's Collection Efforts and Collection Due Process Hearing

2. On June 4, 2021, respondent issued petitioner a Notice of Determination Concerning Collection Action regarding petitioner's liabilities for unpaid civil penalties for tax years 2003 through 2010 (the years at issue). Ex. 1-J.

3. On January 30, 2019, the IRS issued petitioner Letter 1058, Final Notice of Intent to Levy and Notice of Your Right to a Hearing (the levy notice). Ex. 2-J. The levy notice sought to collect petitioner's liabilities for unpaid civil penalties for the years at issue. Stip. ¶ 2. Specifically, the IRS sought to collect section 6038 penalties that the IRS assessed because petitioner was required but failed to file Forms 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations. *Id.*

4. Petitioner timely requested a Collection Due Process (CDP) hearing. On February 19, 2019, petitioner's counsel mailed the IRS a letter enclosing a Form 12153, Request for a CDP or Equivalent Hearing. Ex. 3-J. Among other things, petitioner disputed whether the IRS has legal authority to assess section

6038 penalties (the assessment authority issue[2]). Stip. ¶ 4. The attachment to the Form 12153 referred to an earlier and related Form 12153 dated November 26, 2018, for the income tax liabilities for the same years.[3] *Id.*; Ex. 4-J.

5. The settlement officer obtained verification from the IRS that the requirements of any applicable law or administrative procedure have been met as required by sections 6320(c) and 6330(c)(1). Stip. ¶ 5. The settlement officer considered issues raised at the hearing and whether any proposed collection action balanced the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary. *Id.* Except for the assessment authority issue in dispute, any error by the settlement officer was a harmless error and the settlement officer did not abuse his discretion in sustaining the proposed levy. *Id.*

III. The Section 6038 Penalties

6. During the years at issue, petitioner participated in an illegal scheme for which he was granted immunity in a non-prosecution agreement he signed on September 20, 2012. Stip. ¶ 6; Ex. 5-J.

7. On February 14, 2012, petitioner signed an affidavit describing his role in the illegal scheme. Stip. ¶ 7; Ex. 6-J.

---

[2] The assessment authority issue is the sole issue that remains in dispute.

[3] The parties resolved the CDP case for petitioner's income tax liabilities via a stipulated decision. *See* Docket No. 11202-21L. The CDP hearings were held concurrently.

8. During the years at issue, petitioner wholly owned Katumba Capital Inc., a foreign corporation formed in Belize. Stip. ¶ 8.

9. During at least 2005 through 2010, petitioner wholly owned Morningstar Ventures, Inc., a foreign corporation formed in Belize. Stip. ¶ 9.

10. For the years at issue, petitioner had a reporting requirement under section 6038(a), to report his wholly owned interests in both Katumba Capital Inc. and Morningstar Ventures, Inc. Stip. ¶ 10. For the years at issue, Form 5471 was the method prescribed by the Secretary for complying with the section 6038(a) reporting requirement. *Id.*

11. For the years at issue, petitioner was required to timely file Forms 5471. He did not. Stip. ¶ 11.

12. On February 9, 2016, the IRS mailed petitioner notice of his failure to file the required Forms 5471 for the years at issue. Stip. ¶ 12.

13. Petitioner never filed Forms 5471 for the years at issue. Stip. ¶ 13.

14. For each year at issue, petitioner willfully failed to file the Forms 5471 and his failure was not due to reasonable cause. Stip. ¶ 14.

15. On November 5, 2018, the IRS assessed an initial penalty of $10,000 for each year at issue. Stip. ¶ 15.

16. On November 12, 2018, the IRS assessed continuation penalties of $50,000 for each year at issue. Stip. ¶ 16.

17. For the years at issue, the IRS complied with the written supervisory approval requirements under section 6751(b) regarding the section 6038 penalties. Stip. ¶ 17.

ULTIMATE FINDINGS OF FACT

1. The Commissioner has legal authority and a duty to assess section 6038 penalties.

2. The Commissioner has legal authority to assess section 6038 penalties without the prior issuance of a statutory notice of deficiency.

3. The Commissioner has legal authority and a duty to collect assessed section 6038 penalties without a suit referral to the Department of Justice.

4. Petitioner is liable for section 6038 penalties in the amount of $60,000 per year for the years at issue.

5. Respondent did not abuse his discretion in sustaining the levy action.

POINTS RELIED UPON

The IRS has both authority and a duty to assess section 6038 penalties because section 6201(a): (1) broadly defines the term "taxes" to include section 6038 penalties; (2) explicitly grants the IRS assessment authority; and (3) imposes a duty on the IRS to make assessments, inquiries, and determinations of tax to ensure compliance with the Code.

Section 6038 penalties are assessable penalties that the IRS can assess without the prior issuance of a notice of deficiency because the reference to "assessable penalties" in section 6201(a) is broad enough to encompass them even though section 6038 is not contained within subchapter 68B, as "assessable penalties," they are determined without relation to a deficiency, and case law supports that conclusion.

Since section 6038 penalties are "assessable penalties" within the definition of section 6201(a) and the IRS can permissibly assess them without the prior issuance of a notice of deficiency, the IRS can similarly utilize its normal collection mechanisms that apply to every other assessable penalty contained within Title 26 of the Code.

ARGUMENT

I. The Court Need Not Decide Whether the Assessment Authority Issue is a Challenge to Underlying Liability

The sole issue for the Court to decide is whether the IRS has the legal authority and a duty to assess and collect section 6038 penalties. Respondent acknowledges that underlying liability is properly in dispute and that petitioner raised the issue during the CDP hearing. The Court, however, need not decide whether to treat the assessment authority issue as a challenge to underlying liability because it will not change the outcome of this case. The parties have stipulated to all other facts required for the Court to sustain the levy action.

II. The IRS Has Authority and a Duty to Assess Section 6038(b) Penalties Under Section 6201

Section 6038(b) provides that if a person fails to timely furnish information with respect to any foreign business entity as required under subsection (a)(1), that "such person shall pay a penalty of $10,000 for each annual account period with respect to which such failure exists." § 6038(b)(1). If a taxpayer's failure to provide required information persists, section 6038(b)(2) provides for an additional penalty of $10,000 for each 30-day period in which the failure continues, not to exceed $50,000.

The IRS has both broad assessment authority and a duty to make assessments pursuant to section 6201(a): "The Secretary is *authorized* and *required* to make the inquiries, determinations, and assessments of all taxes (including

interest, additional amounts, additions to the tax, and assessable penalties) imposed by [the Internal Revenue Code]." (emphasis added). In contending that section 6201(a) does not authorize respondent to assess the penalty under section 6038(b), petitioner contends that the penalty is neither an assessable penalty nor otherwise a tax within the meaning of section 6201. Section 6201(a) authorizes the IRS to assess section 6038 penalties because they fall within the broad reference to "assessable penalties" in section 6201(a) (as discussed in greater detail in Argument Section III below) and they are included in the expansive meaning of "taxes" under section 6201(a). Not only can the IRS assess section 6038 penalties, but section 6201(a) *requires* the IRS to do so when a taxpayer fails to comply with section 6038.

The parenthetical reference in section 6201(a) to taxes "including . . . assessable penalties" includes the section 6038(b) penalty. As recently recognized by this Court, whether a penalty falls within the meaning of the term "taxes" as used in section 6201(a) is dependent on context. *Grajales v. Commissioner*, 156 T.C. 55, 61 (2021). Rather than limit the definition of "taxes," the parenthetical reference in section 6201(a) includes "interest, additional amounts, additions to the tax, and assessable penalties," which demonstrates that Congress intended to use "taxes" in an expansive sense rather than a narrow one. The modifier "all" preceding "taxes" also reflects that Congress intended to define the "taxes" to be

interpreted under the broadest construction. The only limitation to respondent's broad assessment authority under section 6201(a) is to limit that authority to assessments imposed under Title 26.

Section 6201 uses the reference to "all taxes" to describe not only what the IRS is authorized to assess, but also the scope of inquiries and determinations the IRS is required to make. The IRS has a duty to ensure compliance with taxpayer obligations under section 6038 because of the broad mandate in section 6201. Additionally, the IRS has an extended period of limitations for assessment of taxes under section 6501 when a taxpayer fails to provide the IRS with information required by section 6038. § 6501(c)(8)(A). The authority to assess section 6038(b) penalties is a critical tool used in fulfilling the IRS's duty to ensure taxpayer compliance with the Code.

The IRS also uses the information a taxpayer is required to provide under section 6038(a) to make inquiries and determinations of income taxes, and the assertion of section 6038(b) penalties encourages taxpayer compliance. If section 6201 excluded the section 6038(b) penalty from the scope of "taxes," then that provision would run contrary to the duty that section 6201 imposes on the IRS to make inquiries and determinations of tax. The IRS has both authority and a duty to assess section 6038 penalties because section 6201(a) (1) broadly defines the term "taxes" to include section 6038 penalties; (2) explicitly grants the IRS assessment

authority; and (3) imposes duty on the IRS to make assessments, inquiries, and determinations of tax to ensure compliance with the Code. Section 6038 penalties are a critical tool that the IRS uses to fulfill its obligations.

III. Section 6038 Penalties Are Assessable Penalties

Section 6038 penalties are assessable penalties; as such, not only does the IRS have authority and a duty to assess section 6038 penalties under section 6201(a), but the IRS's assessments of section 6038 penalties are not subject to deficiency procedures. The reference to "assessable penalties" in section 6201(a) is in broad enough to include section 6038 penalties, such that their assessment is not subject to deficiency procedures. While not specifically defined in the Code, assessable means being capable of being assessed.[4] In the content of civil tax penalties, the term "assessable" generally distinguishes between penalties that must relate to a deficiency in order determine them (e.g., the section 6663 civil fraud penalty that equals 75% of a deficiency) and those that do not. To confer jurisdiction to the Court by means of a notice of deficiency, then the penalty must relate to a deficiency. *Smith v. Commissioner,* 133 T.C. 424, 429 (2009) ("We note that this Court has never exercised jurisdiction over an assessable penalty that was not related to a deficiency."). Section 6038 penalties, however, are not

[4] *Assessable*, *Merriam-Webster.com Dictionary,* Merriam-Webster, https://www.merriam-webster.com/dictionary/assessable (last visited September 8, 2022).

determined in relation to a deficiency—they are determined in fixed $10,000 increments based on a failure to provide information and the duration of that failure.

Subchapter 68B of the Code is titled "Assessable Penalties" because, as a general rule, the penalties in that subchapter are not subject to deficiency procedures. *See, e.g.,* §§ 6682(c), 6698(d), and 6699(d). The reference to "assessable penalties" in section 6201(a) is in broad enough to include section 6038 penalties even though section 6038 is not contained within Subchapter 68B of the Code. Section 6201 makes no explicit reference to subchapter 68B and does not limit its reference to "assessable penalties" to those found exclusively within subchapter 68B.

This Court and others have treated section 6038 penalties as assessable and not subject to deficiency procedures. *See Ruesch v. Commissioner*, 154 T.C. 289, 297–98 (2020), *aff'd in part*, *vacated and remanded in part*, 25 F.4th 67 (2d Cir. 2022) [5] (noting that section 6038 penalties lie outside the Court's deficiency jurisdiction and stating a taxpayer may have a prepayment forum to contest section 6038 penalties upon receiving a notice of determination following a CDP hearing

[5] The Tax Court's holding in *Ruesch* remains in full effect for this case under the *Golsen* rule because petitioner resided in Israel when the petition was filed. *Golsen v. Commissioner*, 54 T.C. 742 (1970), *aff'd*. 745 F.2d 985 (10th Cir.1971). (RFOF 1). Pursuant to section 7482(b)(1), any appeal of this case will be to the Court of Appeals for the District of Columbia rather than to the Second Circuit.

where properly raised, but otherwise the remedy is to pay the penalties and file a claim for refund then a refund suit); *see also Dewees v. United States*, 272 F. Supp. 3d 96, 102 (D.D.C. 2017) (in holding the taxpayer failed to state a claim supporting a due process violation in contending that he did not have the opportunity to challenge the section 6038 penalty in Tax Court, the court noted that "[f]ull payment of the amount owed followed by a lawsuit in a district court seeking a refund is a proper procedure for challenging penalties assessed under § 6038." (citing *Wheaton v. United States*, 888 F.Supp. 622, 627 (D. NJ. 1995))), *aff'd*, 767 F. App'x 4 (D.C. Cir. 2019); *Heydemann v. United States*, No. WDQ–07–3362, 2008 WL 2502188, at *2 (D. Md. April 23, 2008) (stating that there is "no requirement that the initial assessment of § 6038 penalties requires prior notice. . . [i]ndeed, courts have found that because § 6038 is a penalty assessment and not a deficiency in tax, no notice is required." (citing *Wheaton*, 888 F. Supp. at 625–26)); *cf. Colliot v. United States*, No. 1:19-cv-212, 2021 WL 2709676, at *7 (W.D. Tx. March 24, 2021) (pursuant to the authority of section 6202, and regulations promulgated by the Secretary, section 6038 penalties are subject to the period of limitations as listed in section 6501(c)(8)). The IRS can permissibly assess section 6038 penalties without the prior issuance of a notice of deficiency, even though section 6038 is not contained within subchapter 68B, because the language in section 6201(a) is broad enough to encompass them as

"assessable penalties," they are determined without relation to a deficiency, and case law supports that conclusion.

IV. The IRS, Not the Department of Justice, Has Authority to Collect Section 6038 Penalties Using Its Ordinary Collection Mechanisms

The IRS has the authority and a duty to assess section 6038 without the prior issuance of a notice of deficiency, and the IRS similarly has the authority to collect section 6038 penalties using its ordinary collection mechanisms. This Court has previously recognized as such. In *Ruesch*, this Court stated that a taxpayer may have a prepayment forum to contest section 6038 penalties upon receiving a notice of determination following a collection due process hearing where the petitioner properly raised the penalties. *Ruesch,* 154 T.C. at 297–98. Notably, in making that finding, the Court cited to *Flume v. Commissioner*, T.C. Memo. 2017-21, a CDP case reviewing an underlying liability challenge to section 6038 penalties where the taxpayer properly raised that issue during the CDP hearing. *Ruesch,* 154 T.C. at 297–98. Although the taxpayer in *Flume* did not raise petitioner's assessment authority argument, the Court must have concluded that the IRS had authority to assess and collect section 6038 penalties because it ruled entirely in respondent's favor and the collection action was sustained. *Flume*, T.C. Memo. 2017-21, at *17. Since section 6038 penalties are "assessable penalties" under section 6201(a), the IRS can permissibly utilize its normal collection mechanisms that apply to every other assessable penalty contained within Title 26 of the Code.

CONCLUSION

As the IRS has authority to assess and collect section 6038 penalties and the parties have stipulated to all other facts required for the Court to sustain the levy action, it follows that the determination of the Commissioner of Internal Revenue, as set forth in the notice of determination, should be sustained.

DRITA TONUZI
Deputy Chief Counsel (Operations)
Internal Revenue Service

Date: September 9, 2022 By: _____

CASSIDY B. COLLINS
Senior Counsel (Los Angeles, Group 3)
(Small Business/Self-Employed)
Tax Court Bar No. CC0656
300 N Los Angeles Street
3018 Federal Building
M/S 9900
Los Angeles, CA 90012
Telephone: (213) 372-4026

OF COUNSEL:
JOSEPH W. SPIRES
Division Counsel
(Small Business/Self-Employed)
SHERRI SPRADLEY WILDER
Area Counsel
(Small Business/Self-Employed:Area 8)
CHRISTINE A. FUKUSHIMA
Associate Area Counsel
(Small Business/Self-Employed)