THE PRICE IS RIGHT: FORMER I.R.S. ATTORNEY DISCUSSES INFORMATION RETURN AND F.B.A.R. PENALTIES

Authors
Stanley C. Ruchelman
Wooyoung Lee

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INTRODUCTION

If a statement was filed and no one reads it, was it filed at all? That is the uncomfortable question many taxpayers will be asking after Daniel Price, a long-time I.R.S. attorney, admitted that the I.R.S. does not read reasonable-cause statements attached to late-filed international information returns.[1]

Many I.R.S. penalties are assessable penalties. This generally means that the I.R.S. is not required to provide the taxpayer with an opportunity to contest the penalty before the I.R.S. levies it. A taxpayer who believes that the penalty is incorrect must file a suit to claim a refund. Assessable penalties include those for failure to file certain information returns, including Forms 5471, *U.S. Persons With Foreign Corporations)*, 5472, *Foreign Corporations With a U.S. Trade or Business*, and 3520, *Foreign Trusts and Gifts*. Penalties start at $10,000 or more and increase with continued noncompliance. Taxpayers who file returns late but have reasonable cause for doing so can attach statements explaining their situation. This can result in a waiver of the penalty.

Mr. Price, who was speaking at an event held by the San Francisco Tax Club, confirmed what many practitioners have suspected. Lengthy delays and vague or even incorrect form responses are common complaints of tax advisers having a cross-border practice. Such experiences are particularly concerning because the taxpayer's route to appeal may be described as "pay first, argue later" rather than appeal first, hopefully not pay at all. If the I.R.S. takes too long in addressing an appeal, the taxpayer must fight the penalty after its assessment and after having to make payment.

Need for Speed

Over the years, the I.R.S. has increased the number of information returns that must be filed by taxpayers. With more obligations come a greater need for enforcement, and it is this area that has given way to resource constraints. Originally, the I.R.S. would only discover missing information returns during audits, leading to a manual assessment of penalties. But beginning in the last decade, the I.R.S. switched many of these penalties to systemic assessment driven by computers. This means that a return filed late will lead to an automatic penalty assessment against the taxpayer. Reasonable-cause statements are supposed to be insurance against a more penalty-friendly system. They benefit both taxpayers and the I.R.S. Taxpayers are benefitted by presenting their case before the tax is assessed. The I.R.S. is benefitted because a harsh penalty system that kicks-in automatically may ultimately reduce

[1] "Ex-Official Confirms IRS Ignores Some Reasonable Cause Statements," *Tax Notes*, February 7, 2022.

voluntary compliance for those honest taxpayers who erred and wish to comply on a go-forward basis.

To keep up the pace, I.R.S. has also delegated many tasks to lower-level employees who are not suited to the task of making discretionary judgments. In theory, there is protection against this. Code §6751(b)(1) requires that an immediate supervisor approve the penalty determination in writing for certain penalties. But according to Mr. Price, the supervisory roles are themselves often delegated down, which makes supervisory approval meaningless.

That many penalties are wrongly assessed is supported by data. The Taxpayer Advocate Service ("T.A.S."), an I.R.S. office that represents taxpayer interests, released a report arguing that systemic assessment of penalties related to Forms 5471 and 5472 is inefficient and legally unsound.[2] In 2018 (the most recent year for which there is data in the report), over half of systemically assessed penalties for Forms 5471 and 5472 were abated. In terms of dollars, this represented almost three fourths (71%) of penalties. Manually assessed penalties for the same year and same forms faced abatement rates of 24% and 8%, respectively.

Beyond efficiency concerns, the T.A.S. believes that the I.R.S. does not even have authority to systemically assess penalties for Forms 5471 and 5472. One view is that Subchapter B ("Assessable Penalties") of Chapter 68 lists all penalties that may be systemically assessed, and Code §§6038 and 6038A (which are responsible for penalties related to Forms 5471 and 5472) are not located there. The I.R.S. believes that assessable penalties are not limited to Subchapter B. Instead, all penalties that are not subject to deficiency procedures (which allow a taxpayer to contest a penalty before assessment) are assessable by default. Code §6201 of the Code provides authority for the I.R.S. to assess assessable penalties.

As for the high abatement rates, the I.R.S. recognizes such rates are "relatively high" and wants to "explore whether there are more efficient methods." In fairness, abatement rates decreased by 17% by number of penalties and 15% by dollar figure from 2014 to 2018. But it is unclear whether this is because of more efficient penalty assessment, less generous abatement, or normal variance.

Given the I.R.S.'s noncommittal response to the T.A.S. report, taxpayers may have to avail themselves of other means. Mr. Price had several suggestions that might give taxpayers more transparency into their individual cases. A managerial conference might get a taxpayer into direct contact with the people evaluating the case. Freedom of Information Act requests may allow a taxpayer to determine whether there was proper, written supervision. Beyond the statements, Form 843 (Claim for Refund and Request for Abatement) may provide a faster route to reclaiming money.

F.B.A.R. PENALTIES

Reasonable-cause statements were not the only penalty-related subject of Mr. Price's talk. Federal courts have found themselves split over the proper way to calculate penalties for non-willful F.B.A.R. reports of FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* violations. U.S. taxpayers who hold foreign

[2] "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," Taxpayer Advocate Service, 2020.

bank and other financial accounts with an aggregate value above $10,000 at any point in a given year must report the accounts on a single, yearly form called the F.B.A.R. The source of the confusion is Code §5321, which limits the penalty for a non-willful "violation of any provision of section 5314" to $10,000. Code §5314 lays out F.B.A.R. requirements. Unhelpfully, the term "violation" is not defined. Under one interpretation, a violation is a failure to file the form. Another holds that each unreported account on the same form is a separate violation.

The different theories can lead to drastically different penalty figures. Alexandru Bittner, a Romanian and American businessman, was not aware of his F.B.A.R. obligations and failed to report his foreign accounts from 2007 to 2011.[3] At trial, the district court applied the per-form standard and set his penalties at $50,000: $10,000 for each annual form. The I.R.S. disagreed and persuaded the Fifth Circuit that penalties should apply per account, leading to a penalty in the amount of $2.72 million.

That decision put the Fifth Circuit at odds with the Ninth Circuit. In *Boyd*, the court dealt with a taxpayer who failed to report 13 foreign accounts during a single year.[4]Using the per-form standard, the Ninth Circuit reversed the district court's decision and capped the penalty at $10,000. *Boyd* relied on *Shultz*,[5] in which the Supreme Court noted that penalties under the Banking Secrecy Act (the legislation that, among other things, created F.B.A.R. obligations) attach to the regulations, not the statute. Treas. Reg. §1010.350(a) requires taxpayers to report accounts on an F.B.A.R. forms, while Treas. Reg. §1010.350(c) creates a deadline for doing so. The taxpayer missed the deadline but still reported her accounts accurately. The court thus found only one violation and one penalty.[6]

Bittner ignored *Shultz*, as *Shultz* was about constitutionality and not interpretation of the penalty provisions. The Fifth Circuit instead noted that the provision on non-willful violations, unlike other parts of Code §5321, do not refer to a "violation of a regulation." The court accordingly focused on the statute, rather than the regulations. The court found a distinction between substantive obligation – reporting the accounts – and procedural requirements – the form used for reporting. The statute centered on the former, while the regulations fleshed out the latter.

The court also drew a comparison with willful penalties. The provision on willful penalties refers to accounts, suggesting that penalties should generally be tied to noncompliance of each account. But given the non-willful penalties provision does not mention refer to accounts, one might question why this was not a definition by omission, which was questioned by the district court and Ninth Circuit. The Fifth Circuit used that logic to conclude that non-willful violations do not attach to regulations. The court's answer was that the cap on willful penalties depends partly on the balance of unreported accounts, while the cap on non-willful penalties is a flat $10,000. The court further observed that the reasonable-cause exception, which can excuse non-willful F.B.A.R. penalties, specifically requires that account

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3 *U.S. v. Bittner*, 991 F.3d 1077.

4 *U.S. v. Boyd*, 19 F.4th 734.

5 *The Calif. Bankers Assn. v. Shultz*, 416 U.S. 21 (1974).

6 This suggests that even the Ninth Circuit would approve of a penalty greater than $10,000 for one form if the form was both filed late and with incorrect information, as, incidentally, Mr. Bittner initially did.

balances be accurately reported. It would be inconsistent to tie the penalty to the form but the exception to the account.

Some taxpayers were relieved when Mr. Price confirmed that the I.R.S. is following the per-form theory in the Ninth Circuit.[7] However, there is no guarantee that this situation will last. The two opinions are incompatible and create uncertainty, not least given the potentially huge disparity in results. The circuit split surely invites resolution of the conflict, perhaps by the Supreme Court.

In the meantime, Mr. Price suggests that those in the Ninth Circuit facing penalties for non-willful F.B.A.R. violations take advantage of *Boyd* by citing the case or requesting the involvement of the Office of Chief Counsel, as attorneys would be more reluctant to ignore precedent than lower-level employees. It is not a guarantee of success, but the potential payoff is worth the effort.

CONCLUSION

A similar calculus applies to the reasonable cause statements attached to information returns. Even if the I.R.S. has been ignoring them, there is still value in the taxpayer following procedure by filing the statement. The statement can provide a paper trail. It can serve as evidence of a consistent story, should a dispute get dragged out. And it might even be read.

[7] "IRS Following *Boyd* FBAR Interpretation in Ninth Circuit Only," Tax Notes, February 7, 2022.