



# TaxNewsFlash

United States



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## U.S. Tax Court: IRS lacks statutory authority to assess penalties under section 6038(b) for willful failure to file Form 5471

The U.S. Tax Court today held that the IRS did not have statutory authority to assess penalties under section 6038(b) against a taxpayer who willfully failed to file Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, for his 2003–2010 tax years. As a result, the IRS could not proceed with collection of such penalties from the taxpayer via the proposed levy.

The case is: *Alon Farhy v. Commissioner*, 160 T.C. No. 6 (April 3, 2023). Read the Tax Court's [opinion](#) [PDF 196 KB] (14 pages)

### Summary

During his 2003 through 2010 tax years, the taxpayer owned 100% of a foreign corporation incorporated in Belize. From 2005 (at the latest) through 2010, the taxpayer also owned 100% of another foreign corporation incorporated in Belize. During the years at issue, the taxpayer participated in an illegal scheme to reduce the amount of income tax that he owed, and on February 14, 2012, he signed an affidavit describing his role in that illegal scheme. He was granted immunity from prosecution in a non-prosecution agreement that he signed on September 20, 2012. For each year at issue, the taxpayer was required under section 6038(a) to file Form 5471, but he did not, and his failure to file the Form 5471 was willful and not due to reasonable cause.

Section 6038(b)(1) imposes a penalty of \$10,000, with respect to each annual accounting period for which a failure exists, if any person fails to timely furnish certain required information with respect to any foreign business entity. Section 6038(b)(2) imposes a continuation penalty of \$10,000 for each 30-day period (or fraction thereof) during which such failure continues with respect to any annual

accounting period after an initial 90-day notice period, subject to a maximum of \$50,000. There is no statutory provision, in the Code or otherwise, specifically authorizing assessment of these penalties.

Section 6201(a) authorizes and requires the Treasury Secretary to make assessments of all taxes (including interest, additional amounts, additions to tax, and assessable penalties) imposed by the Code, which the Treasury Secretary has delegated to the IRS. When a tax is assessed, the IRS may take certain actions to collect the tax administratively.

The taxpayer argued that section 6038(b), unlike a bevy of other penalty sections in the Code, contains no provision authorizing assessment of the penalty it provides for. Therefore, a section 6038(b) penalty is not an assessable penalty, although it may be collected through a civil action. The IRS responded that the term “assessable penalties” includes any penalties found in the Code that are not subject to the Code’s deficiency procedures.

### **Tax Court decision**

The Tax Court agreed with the taxpayer’s reading of the Code and found that the IRS assessed penalties under section 6038(b) against the taxpayer without statutory authority to do so and thus could not proceed with the collection of those penalties from the taxpayer via the proposed levy.

The court noted that Congress explicitly authorized assessment with respect to myriad penalty provisions in the Code, but not for section 6038(b) penalties. The court stated it was “loath to disturb this well-established statutory framework by inferring the power to administratively assess and collect the section 6038(b) penalties when Congress did not see fit to grant that power to the Secretary of the Treasury expressly as it did for other penalties in the Code.”

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