



# GMS Flash Alert

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## United States – D.C. Circuit Reaffirms IRS’ Statutory Authority to Assess Penalties for Failure to File Form 5471

On May 3, 2024, the U.S. Court of Appeals for the D.C. Circuit overturned a U.S. Tax Court ruling in the case of *Alon Farhy v. Commissioner*<sup>1</sup> that had previously concluded the U.S. Internal Revenue Service (IRS) lacked the statutory authority to assess penalties for failure to file Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*. This form is required for reporting a U.S. person’s interests in certain foreign holdings. The reversal means that taxpayers who fail to report foreign holdings will continue to face automatic penalty assessments from the IRS for delinquent international information returns.

### WHY THIS MATTERS

The implications of this ruling are significant for globally mobile employees, as the penalty language at issue in *Farhy* is used in other international information reporting provisions (such as the penalty provisions addressing the failure to timely file Form 8938, *Statement of Specified Foreign Financial Assets*, and Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*).

The reversal means the IRS will continue to automatically assess penalties for failure to timely report foreign holdings, assets, and trusts before consideration of an assignee’s request for relief based on reasonable cause. Resolving these penalties with the IRS can be costly and time-consuming, even when the compliance failure is due to an assignee being inexperienced with U.S. reporting requirements.

### Background

As KPMG previously reported<sup>2</sup>, the case in question involved a taxpayer who wholly owned two foreign corporations incorporated in Belize. The taxpayer failed to report the foreign entities on Form 5471 for each year at issue as required. The failure to file was deemed willful and not due to reasonable cause. The IRS assessed penalties totaling nearly US\$500,000.

The taxpayer argued that the relevant section in the Internal Revenue Code (Code), unlike many other penalty sections, contains no provision authorizing assessment of the penalty by the IRS. As a result, the taxpayer argued that the penalty for failure to file Form 5471 is not an assessable penalty, although it may be collected through a civil action. The IRS argued that the term “assessable penalties” includes any penalties found in the Code that are not subject to the Code’s deficiency procedures.

Last year, the Tax Court agreed with the taxpayer, concluding that the IRS assessed penalties 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.<sup>3</sup>

However, with this ruling the D.C. Circuit Court of Appeals reversed the Tax Court’s ruling, affirming the IRS’s ability to automatically assess penalties under the Code and administratively collect these penalties.

## KPMG INSIGHTS

While the recent ruling is a setback for taxpayers, it is worth noting that a Supreme Court hearing is possible if other circuit courts rule differently in similar cases. Until then, taxpayers are advised to be diligent in reporting their foreign holdings to avoid penalties being assessed by the IRS.

### FOOTNOTES:

1 *Farhy v. Commissioner*, No. 23-1179 (D.C. Cir. May 3, 2024). Read the D.C. Circuit’s [decision](#).

2 See “IRS lacks statutory authority to assess penalties under section 6038(b) for willful failure to file Form 5471,” in *TaxNewsFlash* (April 3, 2023), a publication of KPMG LLP in the United States, by clicking [here](#).

3 *Alon Farhy v. Commissioner*, 160 T.C. No. 6 (April 3, 2023). Read the Tax Court’s [opinion](#).

\* \* \* \*

### RELATED RESOURCE

See “D.C. Circuit: IRS has statutory authority to assess penalties for willful failure to file Form 5471; Tax Court reversed,” in *TaxNewsFlash* (May 3, 2024), a publication of KPMG LLP in the United States, by clicking [here](#).

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