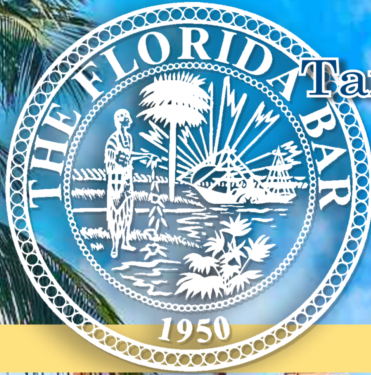

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Is the Section 6039F Penalty the Next Domino to Fall in the Wake of the Farhy Decision?

By Anthony Diosdi

Recently, the United States Tax Court held in *Alon Farhy v. Commissioner of Internal Revenue*,[1] that the Internal Revenue Service or ("IRS") lacked the authority to assess certain penalties against taxpayers under Internal Revenue Code Section 6038(b). For reasons discussed in this article, the IRS may also lack the authority to assess Section 6039F penalties associated with the failure to timely report certain foreign gifts on a Form 3520.

IRS's Assessment Authority

Section 6201(a) authorizes and requires the Secretary of the Treasury to make assessments of all taxes, interest, additions to taxes, and assessable penalties imposed by the Internal Revenue Code. The Secretary of the Treasury has delegated these duties to the Commissioner of the Internal Revenue, who has delegated them in turn to other IRS officials. When a tax, interest, or assessable penalty is assessed, the IRS may take certain actions to collect the tax administratively through means such as liens and levies. If there is no law giving the IRS the authority to assess a penalty, the IRS's only recourse to collect the penalty would be to ask the Department of Justice to sue the individual or entity assessed the penalty.[2]

Section 6039F of the Internal Revenue applies to U.S. persons (other than certain exempt organizations) that receive large gifts (including bequests) from foreign persons. The Section 6039F reporting provisions require U.S. donees to provide information concerning the receipt of large amounts that the donees treat as foreign gifts. Donees are currently required to report certain information about foreign gifts on Part IV of Form 3520.

Section 6039F(b) generally defines the term "foreign gift" as any amount received from a person other than a U.S. person that the recipient treats as a gift or bequest. However, a foreign gift does not include a qualified transfer (within the meaning of Section 2503(e)(2)) or any distribution from a foreign trust. A distribution from a foreign trust must be reported as a distribution under Section 6048(c) and not as a gift under Section 6039F. Section 6039F(c) provides that if a U.S. person fails, without reasonable cause, to report a foreign gift as required by Section 6039F, then 1) the tax consequences of the receipt of the gift will be determined by the Secretary and 2) the U.S. person will be subject to a penalty equal to 5% of the amount for the gift for each month the failure to report the foreign gift continues, with the total penalty not to exceed 25% of such amount. Under Sections 6039F(a) and (b), reporting is required for aggregate foreign gifts in excess of $100,000 during a taxable year. Once the $100,000 threshold has been met, the U.S. donee is required to file Form 3520 with the IRS.

The IRS treats Section 6039F penalties as summarily assessable, as they are not subject to the deficiency procedures, wherein taxpayers receive a notice of deficiency alerting them of the potential assessment and explaining the taxpayer's options for contesting or complying with the penalty assessment. The notice of deficiency also informs taxpayers of the last day to petition the Tax Court for pre-assessment and prepayment judicial review.

Many penalties related to income tax filings are not summarily assessable (that is, they are generally subject to deficiency procedures). For example, deficiency procedures typically apply when the IRS determines noncompliance of a taxpayer resulting in an underpayment of some type of tax. Common penalties associated with the issuance of a notice of deficiency include an accuracy or negligence penalty under Section 6662.

Summarily assessable penalties are primarily found in Section 6671 through 6720C. Chapter 68, Subchapter B, titled "Assessable Penalties," authorizes the IRS to assess and collect penalties "in the same manner as taxes" without first sending a notice of deficiency. Summary assessments are made without the issuance of a notice of deficiency and "shall be paid upon notice and demand and collected in the same manner as taxes." Most of these "penalties" are included in Chapter 68 of the Internal Revenue Code. Chapter 68, Subchapter A, titled "Additions to the Tax and Additional Amounts," allows the IRS to impose penalties for failure to file or pay taxes, understatements or underpayments of tax, and penalties for fraud. However, Chapter 61 penalties are not located in Chapter 68 of the Internal Revenue Code and are not therefore assessable penalties.

The IRS believes it has a grant of authority to assess Section 6039F penalties under Section 6201(a) as a result of a Supreme Court decision in *NFIB v. Sebelius*.[3] As discussed above, this provision of the Internal Revenue Code permits the IRS to assess tax as well as interest and penalties. In *NFIB v. Sebelius*, the U.S. Supreme Court agreed that the plain language of Section 6201(a) places

within the definition of tax for the purpose of granting the IRS the authority to assess Affordable Care Act penalties. To reach this result, the Supreme Court had to clear the hurdle of the prohibition against injunctive relief in tax cases contained in the Anti-Injunction Act.[4] The Supreme Court stated that unlike penalties contained in Chapters 68A and 68B of the Internal Revenue Code, the ACA individual mandate penalty was not designated a tax, even though it was to be assessed and collected like a tax.

Based on the Supreme Court's rationale, none of the penalties contained in Part A III of Chapter 61A can be classified as a "tax." Consequently, the Anti-Injunction Act or the Declaratory Judgment Act would not prevent a taxpayer from filing suit for injunctive or declaratory relief in connection with a penalty contained in Part A III of Chapter 61A. The Supreme Court ultimately determined in *NFIB v Sebelius* that a penalty found in Section 5000A(g)(1) was to be paid upon notice and demand and was assessed and collected in the same way as assessable penalties under Chapter 68B, and as a result, the Affordable Care Act penalty was to be assessed and collected in the same manner as a tax.

The Tax Court's Farhy Reasoning and Farhy Court's Application to Section 6039F Penalties

Based on the Supreme Court's reasoning in NFIB v. Sebelius, a number of the Internal Revenue Code provisions that apply the term "tax" to foreign information reporting penalties are susceptible to challenge. As noted above, in *Farhy v. Commissioner of Internal Revenue*, the Tax Court recognized that certain Internal Revenue Code sections contain their own express provisions authorizing assessment of penalties provided therein, and that such penalties are encompassed with the "assessable penalty" reference in Internal Revenue Code Section 6201(a). In determining the term "assessable penalties" and holding that the Section 6038(b) penalty was not subject to the IRS's assessment authority under Section 6201(a), the Tax Court in *Farhy* compared Section 6038(b) to penalty code sections outside Chapter 68, Subtitle F. The Tax Court in *Farhy* noted that code sections outside Chapter 68 of Subtitle F whose violations the Internal Revenue Code specifically penalizes.

Internal Revenue Code Section 6039F is distinguishable from Internal Revenue Code Section 6038(b), in that it contains language providing that the penalty must be paid upon notice and demand, in the same manner as taxes. Similar language is not present in Internal Revenue Code Section 6038(b). Although Section 6039F provides that the penalty must be paid upon notice and demand, this language is not clearly indicative of the penalty being considered an "assessable penalty" for purposes of the general grant of the IRS's authority to assess "assessable penalties" in Section 6201(a) of the Internal Revenue Code. In order for the IRS to have the authority to assess and collect a Section 6039F penalty, the penalty must be paid upon notice and demand and assessed and collected in the same manner as taxes.[5] While the express language of Internal Revenue Code Section 6039F(c)(1)(B) states that the penalty is payable "upon notice and demand by the Secretary and in the same nature as tax," this express language is missing the key phrase "assessed and collected." The absence of this key phrase "assessed and collected" from the language of Internal Revenue Code Section 6039F(c)(1)(B) could be fatal to the IRS's position that it has the authority under Section 6201 to assess and collect a Section 6039F penalty. The express language is insufficient to transform the penalty into an "assessable penalty"- i.e., Internal Revenue Code Section 6039F(c)(1)(B) penalty is not a penalty as to which the IRS (as the Treasury Secretary's delegate) is authorized by statute to use its administrative powers to levy (i.e., execute, enforce, and collect) on the extent of the penalty that has been determined by the IRS.

About Authour:

***Anthony** focuses his practice on providing tax planning domestic and international tax planning for multinational companies, closely held businesses, and individuals. In addition to providing tax planning advice, Anthony Diosdi frequently represents taxpayers nationally in controversies before the Internal Revenue Service, United States Tax Court, United States Court of Federal Claims, Federal District Courts, and the Circuit Courts of Appeal. In addition, Anthony Diosdi has written numerous articles on international tax planning and frequently provides continuing educational programs to tax professionals. Anthony Diosdi is a member of the California and Florida bars. He can be reached at 415-318-3990 or* adiosdi@sftaxcounsel.com.

Endnotes

1 *Alon Farhy v. Commissioner of Internal Revenue*, 160 T.C. No. 6 (April 3, 2023).

2 *See* IRC Section 2461(a).

3 *National Federation of Independent Business v. Sebelius*, 567 U.S. (2012).

4 *See* IRC Section 7421.

5 *See Smith v. Commissioner*, 133 T.C. 424, 428 (2009).