More on IRS Strategies to Reopen Closed Assessment Periods

Hale E. Sheppard, Esq.

INTRODUCTION

So many things in life are just a matter of time, and disputes over taxes and penalties are no exception. The Internal Revenue Service ("IRS") has a limited period during which to enforce the rules, and taxpayers generally hope to go unnoticed until that opportunity has passed. Timing issues do not disappear, though, simply because taxpayers get selected for audit or approach the IRS to resolve matters pro-actively. Indeed, they might become more important than ever, as many interactions with the IRS involve extensions of assessment-periods, some voluntary, others compulsory. This article, which supplements an earlier one by the same author, analyzes the divergent and surprising rules applicable to taxes and related penalties, on one hand, and sanctions for unfiled FinCEN Forms 114 ("FBARs"), on the other.[1]

EXTENSIONS FOR TAXES AND RELATED PENALTIES

The IRS normally has three years from the date on which a tax return is filed (or deemed to be filed) to complete its audit and propose any adjustments, including additional taxes and related penalties.[2] There are various situations in which the IRS can *impose* an extension of this period against taxpayers. Here are just a few.

First, in situations where taxpayers are obligated to file various international information returns but fail to do so, the assessment-period can be endless.[3] How does this happen? Relevant law provides that, when taxpayers do not disclose their international assets or activities to the IRS by submitting the proper information return, the assessment-period never starts to run.[4] The effect is that the IRS can audit and penalize taxpayers many years after the violation, thereby depriving them of any peace of mind generally gained with the passage of time.[5] Moreover, legislative history clarifies that the expanded assessment-period allows the IRS to sanction the missing information returns, as well as scrutinize all items on the tax return with which it should have been enclosed in the first place.[6]

Second, the IRS has the ability to lengthen the assessment-period from three years to six years in situations where taxpayers omit from their tax returns more than 25 percent of their gross income, or more than $5,000 of any income derived from a long list of foreign financial assets.[7] The result is that rather small income omissions can trigger large exposure to IRS review.[8]

Third, false or fraudulent returns filed by taxpayers trigger infinite opportunities for IRS challenges.[9] No single measure of malevolent intent exists, so the IRS and courts normally explore several possible "badges of fraud." Among them are income understatements, inadequate records, implausible explanations, bogus companies or transactions, dealings in cash, concealment of assets, and obstruction of tax audits and investigations.[10]

Finally, taxpayers exacerbate timing issues when they engage in "listed transactions" and then fail to enclose Forms 8886 (Reportable Transaction Disclosure Statements) with their tax returns. In those instances, the assessment-period remains open until one year after the taxpayers eventually file Forms 8886 or material advisors provide the IRS certain data about the taxpayers, whichever occurs first.[11] During the prolonged period, the IRS can assess any taxes and penalties, regardless of whether they are directly related to the undisclosed listed transactions.[12]

As explained above, the IRS often forces longer assessment-periods on taxpayers, against their will, based on specific laws. Sometimes that is not necessary, however, because taxpayers simply agree to grant the IRS more time to do its initial job. Formal Policy Statements and internal IRS guidance indicate that Revenue Agents generally should complete their work within the normal three-year period, such that seeking extensions is a rarity.[13] Those who regularly defend taxpayers during audits know that this is inaccurate, though. The norm is for Revenue Agents to seek one or more extensions from taxpayers during audits, which are generally memorialized on Form 872 (Consent to Extend the Time to Assess Tax).[14] Savvy taxpayers sometimes concede the IRS additional audit time for strategic, financial, legal and other reasons, the details of which exceed the scope of this article.

A pivotal issue with Forms 872 is timing. The key tax provision and regulations state that the IRS and taxpayer both must consent to an extension in writing "*before* the expiration of the time prescribed for the assessment of any tax" and, in the case of multiple extensions, "*before* the expiration of the period previously agreed upon."[15] Similarly, IRS training materials confirm that the assessment-period "*must still be open* when the [Form 872] is executed by both parties [because] it is *an agreement to extend* the statute of limitations on assessment, *not an agreement to revive* an expired statute of limitations."[16] Several cases, likewise, have held that Forms 872 and similar waivers supplied by taxpayers after assessment-periods expired were invalid.[17]

EXTENSIONS FOR FBAR PENALTIES

This article now turns to a different type of extension, one limited to penalties for unfiled or improper FBARs. Relevant law requires the filing of an FBAR in situations where (i) a U.S. person, (ii) had a direct financial interest in, had an indirect financial interest in, had signature authority over, or had certain other types of authority over (iii) one or more financial accounts (iv) located in a foreign country (v) whose aggregate value was more than $10,000 (vi) at any point during a year.[18]

It is crucial for readers to understand that

Hale E. Sheppard (B.S., M.A., J.D., LL.M., LL.M.T.) is a Shareholder in the Tax Controversy Section of Chamberlain Hrdlicka. Hale specializes in tax audits, tax appeals, and tax litigation. You can reach Hale by phone at (404) 658-5441 or by e-mail at hale.sheppard@chamberlainlaw.com

 © 2024 Thomson Reuters

FBAR duties and penalties are found in Title 31 of the U.S. Code (which addresses financial issues), whereas tax duties and penalties originate in Title 26 (which is the Internal Revenue Code). It is also important for readers to appreciate that taxpayers voluntarily extend FBAR periods by executing a "Consent to Extend the Time to Assess Civil Penalties Provided by 31 U.S.C. 5321 for FBAR Violations" ("FBAR Consent"), while they prolong tax periods with Forms 872.[19] In summary, items that often overlap in the international context involve different issues (*i.e.*, FBAR penalties versus taxes), follow different laws (*i.e.*, Title 31 versus Title 26), and utilize different documents (*i.e.*, FBAR Consents versus Forms 872). These distinctions are critical, as explained below.

Some serious digging unearths three cases in which courts have indicated, contrary to the belief commonly held by taxpayers and tax professionals, that the IRS can obtain an FBAR penalty extension from taxpayers, even after earlier assessment-periods have expired.

The first case is *United States v. Solomon*, where the IRS assessed FBAR penalties for 2004 through 2010.[20] The taxpayer took the position that the assessment-periods for all years except 2010 had expired before the IRS secured the FBAR consents; therefore, the penalties were invalid. The taxpayer argued, among other things, that "Congress did not even specifically authorize any extension of the [assessment] period for FBAR penalties under [Title 31], let alone provide clear congressional intent to allow revival through agreement of expired [assessment] periods."[21] The government, for its part, countered that the six-year period set forth in the relevant provision in Title 31 is a "non-jurisdictional defense that can be waived [by taxpayers], even after it expires."[22] The court agreed with the government, ruling that it was not too late for the IRS to assert FBAR penalties for the relevant years. The key, explained the court, in determining whether a particular assessment-period can be waived is whether it limits the court's jurisdiction. If so, waiver is not possible. Turning the relevant rule in Title 31, the court held as follows:

> It is clear from the face of the limitations period in [Title 31], which does not refer to the court's jurisdiction in any respect, that it operates merely as an affirmative defense [for the taxpayer], not as a limit or condition on the court's jurisdiction . . . Because [the relevant provision in Title 31] is not jurisdictional, the limitations for assessing FBAR penalties may be waived by the parties, even for claims that have expired.[23]

Commentators have been critical of *United States v. Solomon*, particularly the hypocrisy of the government's legal positions in different contexts:

> For years the IRS has argued against the application of the Supreme Court's jurisprudence regarding time periods for filing cases. *It has consistently taken the position that time periods for filing are jurisdictional* in order to keep taxpayers to whom it gave the wrong dates for filing, who never received notices, who were misled by the language of its notices, or had other reasons for missing a filing deadline that it was too bad they experienced these problems *but the jurisdictional nature of time periods for filing required that they not receive the opportunity to go to court* . . . The IRS is consistent in its arguments regarding jurisdiction and time periods except when it's not. *[United States v. Solomon]* puts the shoe on the other foot. The IRS wins the case adopting the arguments made by taxpayers against the jurisdictional nature of time frames. How convenient.[24]

The second case addressing FBAR extensions is *United States v. Herscovici.*[25] The taxpayer apparently failed to file FBARs for 2008 through 2011 to disclose his foreign accounts. The IRS sent the taxpayer the equivalent of an Examination Report on March 29, 2018, explaining why penalties applied. Over a year later, after the original assessment-periods had long expired, the taxpayer executed FBAR consents for all years. Within a month of getting the extra time, the IRS assessed the highest possible FBAR penalties, for "willful" violations. Then, less than a week later, the IRS sent the taxpayer a notice and demand for payment of the FBAR penalties. He failed to hand over the money, so the government filed a collection suit. It appears that the taxpayer did not defend himself or otherwise participate in the trial; therefore, a dispute over timeliness of the FBAR assessment did not arise. The court's perspective on that issue was clear nonetheless:

> The IRS was initially required to assess FBAR penalties for the 2008, 2009, 2010 and 2011 years by June 30, 2015, June 30, 2016, June 30, 2017, and June 30, 2018, respectively. The IRS initiated its assessment of penalties in January 2014, and the proposed penalties for years 2008 through 2011 were issued on March 29, 2018. On July 30, 2019, [the taxpayer] stipulated to extend the 2008, 2009, 2010 and 2011 penalty assessment deadline to June 30, 2020. Following the stipulation, on August 21, 2019, the IRS assessed willful FBAR penalties on [the taxpayer] for years 2008 through 2011, before the stipulated penalty assessment deadline. Accordingly, [this] weighs in favor of granting the [government's] motion for default judgment.[26]

The third case about time limits for FBAR penalties is *United States v. Sinyavskiy*.[27] Judicial endorsement of reviving expired assessment-periods was more subtle there. The taxpayer was a U.S. citizen, he held bank accounts in Switzerland, and he failed to submit timely FBARs for 2006 through 2012. On April 1, 2017, a point at which the normal six-year periods for 2006, 2007, 2008, and 2009 had already expired, the taxpayer executed an FBAR consent for all years. The IRS assessed non-willful penalties against the taxpayer during the extended periods, and then sent a notice and demand for payment. The taxpayer remitted no funds, so the government filed a collection suit. The taxpayer kept his distance, not challenging the penalties or otherwise engaging in the litigation process. The government, therefore, filed a Motion for Default Judgment. The court approved, holding, among other things, that the facts establish that it had jurisdiction to rule on FBAR penalties.[28]

Soon after the issuance of the three cases analyzed above, as well as others perhaps undiscovered by the author, the IRS released a Voluntary Disclosure Practice Examiner Guide Paper for its personnel ("Guide Paper").[29] Consistent with the cases, the Guide Paper indicates that the "FBAR statute may be extended or waived by the taxpayer *after expiration*" and "an expired FBAR statute *can be resurrected* with taxpayer consent."[30] The Guide Paper also explains that an FBAR Consent "is a common law waiver" of the assessment-period, while a Form 872 "is an anomaly for waivers in that it requires an open statute in order to extend."[31] The Guide Paper further states that "unlike Title 26 statutes, Title 31 FBAR statutes *can be resurrected after the statute expire*s through the execution of a consent."[32]

© 2024 Thomson Reuters

CONCLUSION

This article shows that the rules pertaining to taxes and related penalties are clear; the IRS must secure extensions from taxpayers *before* the previous period expires. The situation regarding FBAR penalties appears different, at least for the moment. However, one would expect additional legal clashes on this important issue given the large number of pending FBAR cases, massive penalty amounts in situations involving "willful" transgressions, the fact that the IRS forces taxpayers to execute FBAR Consents as a condition to participating in voluntary disclosure programs, and the reality that the IRS' position has not yet gained support from higher courts. The IRS surely will continue pointing to the three cases discussed in this article, along with its own Guide Paper, when defending FBAR Consents that it obtained after assessment-periods had lapsed. Taxpayers should keep in mind, though, that opinions by lower-level courts and administrative instructions are quite susceptible to challenge.

End Notes

[1] ***See*** Hale E. Sheppard, "IRS Claims It Can Revive Closed Assessment-Periods in International Tax Disputes," 139 JTAX 21 (August 2023).

[2] Section 6501(a).

[3] Common international information returns include Forms 8938 (Statement of Specified Foreign Financial Assets), Forms 5471 (Information Return of U.S. Persons with Respect to Certain Foreign Corporations), Forms 8865 (Return of U.S. Persons with Respect to Certain Foreign Partnerships), Forms 8858 (Information Return of U.S. Persons with Respect to Foreign Disregarded Entities and Foreign Branches), and Forms 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts). For more information about these returns, ***see*** Hale E. Sheppard, "Extended Assessment Periods and International Tax Enforcement: ***Rafizadeh v. Commissioner***, Unreported Foreign Assets, and Use of FATCA Weapons," 44(5) ***Journal of International Taxation*** 25 (2018).

[4] Section 6501(c)(8).

[5] Public Law 111-147 (March 18, 2010), Title V, Subtitle A, Parts I through V, Section 511(b).

[6] U.S. Joint Committee on Taxation. Technical Explanation of the Revenue Provisions Contained in Senate Amendment to the House Amendment to H.R. 1586, Scheduled for Consideration by the House of Representatives on August 10, 2010. JCX-46-10, pg. 37; Chief Counsel Advisory 201147030 (Nov. 25, 2011); IRSIG SBSE-25-0312-022 (March 09, 2012).

[7] Section 6501(e)(1)(A); U.S. Joint Committee on Taxation. Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, The "Hiring Incentives to Restore Employment Act," under Construction by the Senate. JCX-4-10 (Feb. 23, 2010), pgs. 64-66; Public Law 111-147, Hiring Incentives to Restore Employment Act, Section 513(d), March 18, 2010.

[8] IRSIG SBSE-25-0312-022 (March 09, 2012).

[9] Section 6501(c)(1).

[10] ***Meier v. Commissioner***, 91 T.C. 273 (1988); ***Toushin v. Commissione***r, 223 F.3d 642 (7th Cir. 2000); ***Bradford v. Commissioner***, 796 F.2d 303 (9th Cir. 1986).

[11] Section 6501(c)(10); Section 6707A(c)(2); Treas. Reg. § 1.6011-4(b)(2).

[12] Treas. Reg. § 301.6501(c)-1(g)(7); ***See also*** Treas. Reg. § 301.6501(c)-1(g)(8) (Example 14).

[13] Rev. Proc. 57-6; IRM § 25.6.22.2.1 (3-26-2019).

[14] Section 6501(c)(4)(A). Other common extensions are Form 872-A (Special Consent to Extend the Time to Assess Tax), Form 872-B (Consent to Extend the Time to Assess Miscellaneous Excise Taxes), Form 872-D (Consent to Extend the Time on Assessment of Tax Return Preparer Penalties), Form 872-H (Consent to Extend the Time to Assess Tax on a Trust), Form 872-P (Consent to Extend the Time to Assess Tax Attributable to Partnership Items), Form 2750 (Waiver Extending Statutory Period for Assessment of Trust Fund Recovery Penalty), and Form SS-10 (Consent to Extend the Time to Assess Employment Taxes. ***See*** IRM Exhibit 25.6.22-1.

[15] Section 6501(c)(4)(A); Treas. Reg. § 301.6501(c)-1(d).

[16] Internal Revenue Service. Large Business & International Concept Unit. Overview of Statute of Limitations on Assessment of Tax (Nov. 6, 2019) (emphasis added); "IRS Updated Practice Unit on Limitations Period for Assessing Tax," 2020 Tax Notes Today International 71-22 (April 10, 2020).

[17] ***See, e.g., United States v. Spohrer***, 38 AFTR 2d 76-5832 (Dist. Ct. FL 1976); ***Cary v. Commissioner***, 48 T.C. 754, 760 (1967); ***Berry v. Commissioner***, 97 T.C. 339, 347 (1991).

[18] 31 U.S.C. § 5314; 31 CFR § 1010.350(a).

[19] Internal Revenue Manual § 4.26.17.3.1.3 (12-11-2019); Internal Revenue Manual Exhibit 4.26.17-6.

[20] ***United States v. Solomon***, 570 F. Supp. 3d 1195 (S.D. Florida 2021); "Individual Waived Statute of Limitations for FBAR Penalties, 2021 Tax Notes Today International 212-18 (Oct. 27, 2021).

[21] ***United States v. Solomon***, U.S. District Court, Southern District of Florida, Case 9:20-cv-82236, Defendant's Motion for Partial Summary Judgment and Memorandum of Law (Feb. 1, 2021), pg. 7.

[22] ***United States v. Solomon***, 570 F. Supp. 3d 1195, 1201 (S.D. Florida 2021).

[23] ***Id***.

[24] Keith Fogg, "IRS Succeeds in Jurisdictional Argument, With a Twist," Tax Notes (Nov. 4, 2021).

[25] ***United States v. Herscovici***, U.S. District Court, Central District of California, Case 2:21-cv-06150.

[26] ***United States v. Herscovici***, U.S. District Court, Central District of California, Case 2:21-cv-06150, Civil Minutes regarding Second Motion for Default Judgment (May 16, 2022), pg. 9.

[27] *United States v. Sinyavskiy*, U.S. District Court, Eastern District of New York, Case 1:21-cv-02757.

[28] *United States v. Sinyavskiy*, U.S. District Court, Eastern District of New York, Case 1:21-cv-02757, Report and Recommendation (July 29, 2022); Tax Notes Doc. 2022-25160.

[29] Internal Revenue Service. Voluntary Disclosure Practice Examiner Guide Paper (Rev. 1/26/22); IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022); Andrew Valverde, "IRS Voluntary Disclosure Guide Reveals New Details of Practice," 2022 Tax Notes Today Federal 138-3 (July 20, 2022).

[30] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 39 (emphasis in original).

[31] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 38.

[32] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 48 (emphasis added).

© 2024 Thomson Reuters