The IRS "Stacks" International Penalties in Foreign Trust Disputes: Two Recent Cases and Earlier IRS Guidance Reveal the Playbook

By Hale E. Sheppard*

Hale E. Sheppard analyzes two recent cases and earlier IRS guidance showing how the IRS used, and likely will continue using, penalty stacking as a serious enforcement tool.

I. Introduction

Kicking somebody when they are down is one thing, but kicking them repeatedly is another. Several recent cases demonstrate that the U.S. Internal Revenue Service ("IRS") is doing exactly that in international tax disputes, with the approval of the courts. This process, often referred to as "stacking" penalties, means imposing multiple sanctions against the same taxpayer, for the same year, in connection with the same problem. Given the magnitude of many international fines, this type of "stacking" by the IRS can cause taxpayers to go backward financially, owing far more in penalties than the non-compliant foreign assets were ever worth.

This article explains common U.S. international tax and information-reporting duties, describes the IRS's current "compliance campaign" focused on foreign trusts, and analyzes two recent cases and earlier IRS guidance showing how the IRS used, and likely will continue using, penalty stacking as a serious enforcement tool.

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II. International Duties and Downsides

To understand the issues raised in this article, one must first understand common duties triggered by owning foreign assets and/or engaging in foreign activities, along with the relevant sanctions for disobeying them.

A. Overview of Tax and Information Reporting

Individual taxpayers with foreign assets and/or activities ordinarily are required to do several things with the IRS, including, but certainly not limited to, the following:

- They must declare on Form 1040 (*U.S. Individual Income Tax Return*) income derived from all sources, including passive and active income generated abroad.
- They must disclose on Schedule B (Interest and Ordinary Dividends) to Form 1040 the existence and location of foreign accounts.
- They must electronically file a FinCEN Form 114 ("FBAR") to provide more details about foreign accounts.
- They must report foreign financial assets, as this term is broadly defined, on Form 8938 (*Statement of Specified Foreign Financial Assets*).
- In situations where taxpayers hold interests in and/or have certain other links to foreign entities, they must report them on 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*), Forms 3520 (*Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*), and/or Forms 3520-A (*Annual Information Return of Foreign Trust with a U.S. Owner*), depending on the classification of the entities.
- They must file a Form 8833 (*Treaty-Based Return Position Disclosure*) if they are claiming that the application of a treaty between the United States and another country overrules or modifies normal treatment.

B. Potential Penalties

This article could go on for pages about penalties, critical definitions, mitigation standards, and the like, but that would be overkill. The discussion below is limited to the penalties raised in the two relevant cases.

1. Penalties Linked to Tax Liabilities

Taxpayers who omit income from foreign activities and assets often face significant penalties directly tied to their tax liabilities with the IRS. Examples include negligence penalties equal to 20 percent of the tax debt, penalties rising to 40 percent in situations involving undisclosed foreign financial assets, and penalties reaching 75 percent where the IRS can prove civil fraud.[1] The IRS also imposes interest charges, compounding mercilessly, on both the tax liabilities and penalties.[2]

2. Penalties Linked to Foreign Accounts

Taxpayers can suffer large sanctions for unfiled FBARs. Under current law, the IRS may assert a penalty on any person who fails to file a required FBAR, period.[3] In the case of non-willful violations, the maximum penalty is $10,000 per incident.[4] Higher penalties come into play where willfulness exists. Specifically, when a taxpayer willfully files a late, inaccurate, or incomplete FBAR, the IRS may assert a penalty of $100,000 or 50 percent of the balance in the relevant accounts at the time of the violation, whichever amount is larger.[5] Given the multi-million dollar balances in many unreported accounts, given that the IRS can assert penalties on an account-by-account and year-by-year basis, and given that the assessment period for FBAR violations is six years instead of the normal three, FBAR penalties can be massive.[6]

3. Penalties Linked to Foreign Trusts

The two relevant cases center on sanctions related to foreign trusts, so more context is warranted here.

a. Duties of Responsible Parties, Owners, and Beneficiaries. Three main information-reporting duties exist with respect to foreign trusts. First, a "responsible party" generally must file a Form 3520 within 90 days of certain "reportable events."[7] For these purposes, the term "reportable event" includes the creation of any foreign trust by a U.S. person, the transfer of any money or other property to a foreign trust by a U.S. person, and the death of a U.S. person, if such person was the "owner" of any portion of the foreign trust under the grantor trust rules or any portion of the foreign trust was included in the person's gross estate.[8]

Second, if a U.S. person is the "owner" of any portion of a foreign trust under the grantor trust rules at any time during a year, then he "shall submit" such information as the IRS prescribes. Additionally, he "shall be responsible to ensure" that the trust files a Form 3520-A and furnishes the required information to each U.S. person who is treated as an owner of any portion of the trust and/or who receives any distribution from the trust.[9]

Third, a U.S. person ordinarily must file a Form 3520 if such person receives during the year any distribution from a foreign trust.[10] The IRS has issued guidance featuring a broad definition of "distribution."[11]

b. Penalties. The penalty for not filing a timely, complete and accurate Form 3520 is $10,000 or 35 percent of the so-called "gross reportable amount," whichever is larger.[12] If the violation involves Form 3520-A (pertaining to owners of foreign trusts) instead of Form 3520 (pertaining to responsible parties and beneficiaries), then the penalty is reduced from 35 percent to five percent.[13] Taxpayers might also be hit with a so-called "continuation penalty," if they fail to submit the necessary Forms 3520 and/or Forms 3520-A after the IRS notifies them of the infraction. Specifically, if taxpayers refuse to become compliant within 90 days of notice, then the IRS will assess an additional penalty of $10,000 per month.[14] The IRS will not assert Form 3520 or Form 3520-A penalties where there is "reasonable cause" for the violation and it was not due to "willful neglect."[15]

Unlike a long list of penalties that are affiliated with tax returns (such as negligence, late filing, late payment, civil fraud, etc.), Form 3520 and Form 3520-A penalties are "assessable" penalties, which means that the IRS immediately imposes them and starts collection actions. The normal deficiency procedures do not govern.[16]

III. Foreign Trust Compliance Campaign

The IRS has been aggressively targeting various types of international tax compliance in recent years. Case in point, in May 2018, the IRS introduced a "compliance campaign" centered on foreign trusts, Forms 3520, and Forms 3520-A. According to the IRS, the campaign involves "a multifaceted approach to improving compliance with respect to the timely and accurate filing of information returns reporting ownership of and transactions with foreign trusts."[17] The cases examined below confirm that the IRS's dislike of foreign trust non-compliance predates the current campaign.

IV. One Penalty Stacking Case

One noteworthy case is *Wilson*.[18] It addresses penalty stacking in situations where one U.S. person plays two roles with respect to a foreign trust.

A. Initial Decision by the District Court

The holding by the District Court in *Wilson* centered on a novel issue, yet it received little attention from the tax community at the time.

1. Relevant Facts

The taxpayer, in anticipation of a divorce action by his spouse, formed the Perfect Partner Trust ("PPT") in 2003. The taxpayer was both the grantor and sole beneficiary, which is the key to this case. PPT held accounts in Switzerland and Liechtenstein. The inevitable divorce proceeding began in 2004 and concluded around 2007. With no further need for holding assets abroad, the taxpayer terminated PPT in 2007 and had all funds wire transferred back to domestic accounts. The funds had grown to around $9.20 million by then.

The IRS began an audit of the taxpayer and eventually assessed a penalty of approximately $3.2 million on the following building blocks. The taxpayer was the "beneficiary" of PPT and he received a distribution in 2007 (*i.e.*, the wire transfer when he terminated PPT). As a beneficiary, he was required to file a timely, accurate, complete 2007 Form 3520 reporting the distribution under Code Sec. 6048(c). Because he failed to do so, the proper penalty was 35 percent of the total distribution. In situations where the taxpayer is both an owner *and* a beneficiary of a foreign trust, and the taxpayer fails to file Form 3520 *and* Form 3520-A, the IRS can assess one penalty for 35 percent of the gross reportable amount under Code Sec. 6048(c) and/or one for five percent under Code Sec. 6048(b). The IRS chose the higher penalty, logically.

The taxpayer disagreed with the penalty, but he paid it anyway. He then filed a timely Form 843 (*Claim for Refund*). The IRS may allow a Claim for Refund in cases where a taxpayer has overpaid.[19] The first step to recouping the cash is for the taxpayer to file a Claim for Refund.[20] If the IRS formally denies it by issuing a Notice of Disallowance, then the taxpayer can seek immediate help from the courts by initiating a Suit for Refund.[21] The taxpayer can also file a Suit for Refund if the IRS simply fails to respond to the Claim for Refund within six months.[22] The latter is what occurred in *Wilson*. The taxpayer filed a timely Claim for Refund, and the IRS simply ignored him. Therefore, the taxpayer exercised his right to file a Suit for Refund with the District Court.

Notably, the taxpayer, who was nearly 90 years old back when he formed PPT many years ago, died in 2019 amid the procedural squabbling. The estate assumed the battle from that point forward.

2. Main Arguments by the Taxpayer

The Complaint filed by the taxpayer's estate, as well as various other pleadings lodged with the District Court, reveal three main arguments as to why the taxpayer was entitled to a full refund.

First, the taxpayer was both the owner and sole beneficiary of PPT, such that the IRS *only* had the right to assess a penalty equal to five percent under Code Sec. 6048(b) (as the owner of PPT), *not* a penalty of 35 percent under Code Sec. 6048(c) (as the beneficiary of PPT). In support of this argument, the estate emphasized that (i) the legislative history indicates that Congress did not intend for the 35 percent penalty to apply to taxpayers with a dual owner/beneficiary role, (ii) the relevant tax provisions are ambiguous, and the rules of statutory construction state that murkiness must be interpreted in favor of the taxpayer, (iii) there is no caselaw directly on point, and (iv) IRS guidance, supplied in the form of Instructions to Form 3520 and Form 3520-A, supposedly indicates that the 35 percent penalty is inapplicable.

Second, the estate argued that any penalty would be based on the "gross reportable amount," which, in the case of the failure of an owner to file a Form 3520-A, means the gross value of the relevant portion of "*the trust's assets at the close of the year*." The taxpayer completely emptied the foreign accounts held by PPT during 2007 by wiring all funds back to domestic accounts, such that the value of the assets held by PPT as of the key date (*i.e.*, December 31, 2007) was $0. Consequently, the penalty, even if one were to apply, would be $0.

Third, regardless of which penalty is applicable, the taxpayer should be exempt because there was "reasonable cause" for the violation in 2007 and he did not act with willful neglect. The Complaint and other filings with the District Court were meager on this point, simply stating that the taxpayer was an elderly, retired businessman when he formed PPT, he was unaware of the information-reporting requirements in 2007, he was never advised about such requirements, and the Internal Revenue Manual indicates that ignorance of the law equates to reasonable cause in certain circumstances.

3. Analysis by the District Court

The District Court ruled in favor of the taxpayer on the following grounds. First, applying longstanding doctrines of statutory construction, the District Court determined that Code Sec. 6677 is clear on its face in that the IRS cannot penalize the owner of a foreign trust as a beneficiary. This is because it provides "a clear instruction" to "substitute" or "replace" the five percent penalty for the 35 percent penalty, not to select between the two, not to impose both, and not to ignore one.

Second, even if the preceding conclusions were not "inescapably evident" from the text of Code Sec. 6677, the District Court held that ambiguous tax statutes must be interpreted strongly against the IRS and in favor of taxpayers.[23]

Third, the District Court reasoned that, if it were to accept the position advanced by the IRS, this would result in "an irreconcilable textual conflict." Code Sec. 6677 indicates that once the IRS has determined the "gross reportable amount," it must ensure that the penalties do not surpass it. The District Court acknowledged that this limit is primarily concerned with large "continuation penalties" for ongoing non-compliance after the IRS issues a penalty notice, but explained that the underlying directive appears to place a ceiling on *all* penalties. Consequently, concluded the District Court, "it follows that a taxpayer should not be liable for any two penalties if their combined assessment would add up to more than the gross reportable amount for any one violation." Because the "gross reportable amount" for a violation of Code Sec. 6048(b) is the value of the foreign trust's assets at the close of the relevant year, and because the value of PPT was $0 as of December 31, 2007, the penalty of $3,221,183 assessed by the IRS would exceed $0, and thus violate Code Sec. 6677.

Fourth, guidance from the IRS supports the notion that an owner of a foreign trust who receives a distribution should be treated as an owner, not a beneficiary. The District Court pointed to the IRS's Instructions to the 2007 Form 3520, which expressly state that if the taxpayer is an owner of a foreign trust, received a distribution from such trust, and properly reported all information required on Part II of Form 3520, and if the trust itself filed a separate Form 3520-A, then the taxpayer would not need to disclose the distribution he received on Part III of Form 3520. This makes sense as a method of avoiding unnecessary duplication, but the District Court saw it through a different lens. Specifically, the District Court explained that Part II of Form 3520 is only to be completed by the "owner" and Form 3520-A, likewise, is filed by the "owner." Extrapolating from this, the District Court concluded that Form 3520 disregards the beneficiary status of the owner in favor of his owner status, at least for purposes of tracking distributions to the owner.

Finally, the District Court described its overall holding as follows: "The IRS can therefore assess *only* the 5% penalty under [Section 6677]—not *both* or *either* the 5% and/or 35% penalty—for [the taxpayer's] untimely filing of his 2007 Form 3520." It added that the penalty, derived from the "gross reportable amount," is five percent of the value of "the trust's assets at the close of the year." Because the value of PPT was $0 at the end of 2007, the penalty under the lower five percent rule would be $0.

B. Recent Decision by Court of Appeals

The Department of Justice ("DOJ") asked the Second Circuit Court of Appeals to review the earlier determination by the District Court.[24] Suffice it to say that the Court of Appeals and District Court did not see eye to eye.

The Court of Appeals began by explaining that Code Sec. 6048(c) demonstrates that when a "U.S. person" fails to report to the IRS a distribution from a foreign trust, he triggers a penalty equal to 35 percent of the "gross reportable amount" under Code Sec. 6677. The Court of Appeals then noted that the term "U.S. person" generally includes "everyone [and] makes no exception for a beneficiary who is also the owner of a foreign trust." The taxpayer in *Wilson* was a U.S. person who did not file a Form 3520 to disclose the distribution of about $9.20 million in 2007. Therefore, concluded the Court of Appeals, the IRS was correct in imposing the 35 percent penalty.[25]

The Court of Appeals underscored then that "[n]othing in other parts of [Sections] 6084 and 6677 diminishes or eliminates the applicability of the 35% penalty to [the taxpayer] as a beneficiary of the trust."[26] It also pointed out that the District Court was, well, flat wrong in its reasoning because the relevant provisions do not call for displacing of one of the filing requirements or merging the two filing requirements in situations where a taxpayer is both the owner and beneficiary of a foreign trust.

The Court of Appeals further questioned the District Court's conclusion that the penalty of $3.2 million assessed by the IRS somehow exceeded the "gross reportable amount." It explained that the phrase "gross reportable amount" has two different meanings in Code Sec. 6677, it applies on a violation-by-violation basis, and 35 percent of about $3.2 million does not surpass $9.2 million, which was the "gross reportable amount" of the distribution received in 2007.[27]

Next, the Court of Appeals rejected the position, previously accepted by the District Court, that only one penalty can apply to a taxpayer because Code Sec. 6677(a) states that if a person obligated to file "*any* notice or return" under Code Sec. 6048 fails to do so, he "shall pay *a* penalty" equal to 35 percent. The District Court seized on the word "a" to justify a singular penalty, whereas the Court of Appeals looked to the word "any" to prove the possibility of multiple penalties in cases involving multiple returns, like Form 3520 and Form 3520-A.[28]

The Court of Appeals summarized its ruling as follows:

> The plain language of [Sections] 6048 and 6677 requires that when an individual fails to timely report the distributions she received from a foreign trust, then a 35% penalty applies; her concurrent status as owner of the trust does not alter this rule. Because the statute's meaning is clear based from its text, we need not consider any extrinsic sources.[29]

The Court of Appeals went on to discredit the earlier reasoning by the District Court grounded in the IRS's Instructions to Form 3520, which describe a limited waiver on the amount of information that a taxpayer must supply in rare situations where the taxpayer is the owner of the foreign trust, he received a distribution, he filed a proper Form 3520 for himself, and the trust filed a Form 3520-A containing detailed information about the distribution.[30]

Lastly, because the Court of Appeals had already concluded that the two relevant tax provisions, Code Secs. 6048 and 6677, were not ambiguous, it rebuffed the taxpayer's position that any doubt about tax penalties must be construed against the IRS.[31]

V. Another Penalty Stacking Case

Wilson involved the IRS penalizing one taxpayer, two times, for playing two different roles, with respect to one foreign trust. The next case, *Garrity*, is a variation on the "stacking" theme.[32] It focuses on the IRS's ability to impose multiple penalties in connection with the same foreign events.

A. Relevant Facts

The taxpayer ("Paul") established a so-called Stiftung in Liechtenstein ("Foreign Trust") in 1989. Paul was named the primary beneficiary of the Foreign Trust from inception, and, during his lifetime, he retained the right to amend or revoke the governing documents.

Paul entered into an agreement with the foreign trustee ("Foreign Trustee"), which mandated that all members of the Board of Directors of the Foreign Trust act in accordance with Paul's instructions. In 1989, Paul also opened an account in Liechtenstein in the name of the Foreign Trust ("LGT Account"). The Foreign Trustee then formed a company in the British Virgin Islands ("Foreign Corporation") and opened an underlying account there ("Standard Chartered Account"). All documents related to this structure were either signed or initialed by Paul.

Paul instructed the Foreign Trustee to arrange for "suitable documentation" between his domestic company and the Foreign Corporation, showing that the former was supposedly paying the latter for providing certain services. The DOJ claims that the Foreign Corporation never performed any services, and the sole purpose of the arrangement was to disguise transfers of pre-tax funds from the domestic company, through the Foreign Corporation, to Paul and his LGT Account.

Paul died in 2008, at the age of 84. The IRS started an audit three months later. In late 2009, representatives of Paul's estate filed various tax returns, international information returns, and FBARs for 2003 through 2008, attempting to participate in the Offshore Voluntary Disclosure Program ("OVDP"). The IRS rejected the OVDP application because the audit had already started.

B. Protracted Battle on Four Fronts

Garrity is fascinating for a number of reasons, one of which is that the fight with the U.S. government took place on four fronts simultaneously. They are described below.

1. Income Tax Case

The IRS issued a Notice of Deficiency for unpaid taxes, accuracy-related penalties, and interest related to the 2005 Form 1040. Representatives of Paul's estate filed a timely Petition, the case sat with the Tax Court while other battles raged on, and the parties ultimately settled matters, presumably on terms favorable to the IRS, after seven years.[33]

2. FBAR Penalty Case

Along with demanding additional taxes, the IRS assessed a willful FBAR penalty for 2005 related to the LGT Account. The balance in the account on the date of the FBAR violation (*i.e.*, June 30, 2006) was at least $1,873,382; therefore, the IRS asserted a penalty equal to 50 percent of that amount, or $936,691.

The DOJ made the following allegations with respect to the FBAR violation: (i) Paul did not report the existence of the LGT Account on Schedule B to the 2005 Form 1040 in response to the foreign account question; (ii) Paul executed his 2005 Form 1040 under penalties of perjury, thereby indicating that he had reviewed Schedule B; (iii) Paul did not report any income generated by the Foreign Trust or the LGT Account on his 2005 Form 1040; (iv) Paul did not notify his accountant about the LGT Account; and (v) Paul failed to file an FBAR. The jury sided with the DOJ on all points, agreeing that Paul's FBAR violation in 2005 was "willful."

To streamline the dispute and not waste resources, the DOJ and representatives of Paul's estate had entered into a pre-trial Stipulation in the FBAR penalty case, which indicated that, if the jury were to determine that the FBAR violation was "willful," then the parties would be given the opportunity to file post-trial briefs about the proper FBAR penalty amount.

The representatives of Paul's estate advanced the following argument in challenging the size of the FBAR penalty. The Eighth Amendment to the U.S. Constitution states that "[e]xcessive bail shall not be required, *nor excessive fines imposed*, nor cruel and unusual punishments inflicted." Under the relevant two-prong standard developed by the Supreme Court, the Eighth Amendment will invalidate a penalty if it is at least partly punitive and it is "grossly disproportional" to the level of the violation. Among other things, the representatives pointed out that the IRS "simply stacked" multiple penalties for FBAR, Form 3520, and Form 3520-A violations to trigger a "massive combined penalty" of more than $2.5 million, which far exceeds the total amount in the unreported LGT Account.[34]

The DOJ urged the District Court to reject the "stacking" argument for the following several reasons. First, the DOJ denied that these items are related in any manner, considering that they are imposed under entirely separate parts of the U.S. Code (*i.e.*, Title 31 for FBAR penalties and Title 26 for Form 3520 and Form 3520-A penalties) and that they relate to different behaviors (*i.e.*, failing to report information about foreign accounts versus foreign trusts). Second, the DOJ explained that taxpayers are free to organize their affairs in the manner they choose, but they are stuck with the tax consequences of their choices. In *Garrity*, Paul elected to hold the LGT Account through the Foreign Trust and report neither to the IRS; therefore, his estate must live with the ramifications.[35] Third, the FBAR penalty and Form 3520 and Form 3520-A penalties are not considered "fines" for purposes of the Eighth Amendment because they serve a remedial, not punitive, purpose.[36]

The District Court sided with the DOJ. It said that, even assuming that the penalties at issue constitute "fines" for purposes of the Eighth Amendment, the FBAR violation is "legally and factually distinct" from the Form 3520 and Form 3520-A violations. The District Court then explained that the FBAR case only involved 2005, whereas the Foreign Trust case encompassed 1996 through 2008. It further noted that it was Paul's failure to file the proper information returns, not the mere existence of the underlying LGT Account, which triggered the penalties. Finally, the District Court emphasized that the elements of each violation are different. It ended its analysis on this point concisely: "In short, the penalties in the Foreign Trust case relate to different conduct in different years than in the [FBAR] case." The District Court, therefore, refused to take into account the size of any Form 3520 or Form 3520-A penalties in analyzing whether the FBAR penalty violated the Eighth Amendment.[37]

The District Court ultimately upheld the entire FBAR penalty assessed by the IRS, and then some. The total amount consisted of an FBAR penalty of $936,691 (representing 50 percent of the balance in the unreported LGT Account on the date of the violation), plus a late-payment penalty of about $338,000, plus interest of over $56,000.[38]

C. Form 3520 and Form 3520-A Penalty Case

As explained above, Paul established the Foreign Trust in 1989. He was named the primary beneficiary from inception, and, while he was alive, he retained the right to amend or revoke the governing documents. Paul entered into an agreement with the Foreign Trustee, pursuant to which the members of the Board of Directors were required to follow instructions from Paul or somebody acting on his behalf. Based on these facts, the U.S. government took the position that Paul "exercised complete control" over the Foreign Trust and should have filed Forms 3520 and Forms 3520-A for many years.

The IRS assessed penalties for unfiled Forms 3520 for 1996, 1997, 1998, and 2004, as well as for unfiled Forms 3520-A for 1997 through 2008. When the representatives of Paul's estate refused to pay, the DOJ filed a collection lawsuit in District Court, seeking a total of $1,504,388.[39]

The representatives challenged the DOJ on two grounds. First, with respect to Forms 3520, they argued that the DOJ failed to allege any facts in its Complaint establishing precisely which "reportable transactions" occurred during the relevant years.[40] Second, the representatives claimed that "stacking penalties" against Paul was unconstitutional in that it violated the Eighth Amendment prohibiting excessive fines. The representatives cited the proposed FBAR penalties of approximately $1.1 million (addressed in the District Court action), accuracy-related penalties of about $13,000 (addressed in Tax Court), and the proposed Forms 3520 and Forms 3520-A penalties surpassing $1.5 million. The representatives urged the District Court to hold that the U.S. government "unconstitutionally stacked" penalties against Paul in connection with the same activities, entities, and funds.[41]

The representatives of Paul's estate ultimately settled the Foreign Trust matters with the DOJ, without a trial, paying a total of $850,000 to resolve all Form 3520 and Form 3520-A penalties.[42]

D. Probate Court

The DOJ also filed a claim in the Probate Court against Paul's estate, presumably requesting an amount equal to all the liabilities described in the preceding suits in Tax Court and District Court.[43] The representatives of Paul's estate had previously mentioned that, in addition to penalties, the estate had already paid approximately $1 million in U.S. estate tax on the value of the Foreign Trust.[44]

VI. IRS Guidance Predating *Wilson* and *Garrity*

The IRS adopted a decade ago positions similar to those advanced in *Wilson* and *Garrity*. Thus, if taxpayers and their advisors were paying attention, they could have predicted the IRS's arguments and prepared for them.

In Chief Counsel Advice 201150029 ("CCA"), which dealt with the issue of whether multiple penalties assessed under Code Sec. 6677 could be considered a "divisible tax," the IRS advanced the idea that Code Sec. 6048 mandates "three distinct and separate reporting obligations." These pertain to U.S. persons who create or transfer property to foreign trusts under Code Sec. 6048(a), owners of foreign trusts under Code Sec. 6048(b), and U.S. beneficiaries who receive distributions under Code Sec. 6048(c). The CCA then explained that "Section 6677 imposes a penalty for *each failure* to meet the requirements of Section 6048, [such that] where there are multiple, unreported transactions during the taxable year, the U.S. person will owe a penalty for each unreported transaction." The CCA also stated that "[a] penalty assessment under section 6677, therefore, can reflect an aggregate of penalties imposed for multiple failures to meet any of the reporting obligations imposed by Section 6048."

VII. Conclusion

This article demonstrates that the IRS is determined to identify and punish foreign trust violations. One of its most powerful weapons is the ability to "stack" international penalties in various ways. *Wilson* features "stacking" in the sense that the IRS can penalize one taxpayer, two times, with respect to one foreign trust, based on two separate roles (*i.e.*, owner and beneficiary) played by the taxpayer. *Garrity* is a variation on the "stacking" theme. It focuses on the IRS's ability to impose multiple penalties, against the same taxpayer, derived from the same foreign events. *Garrity* shows that even a basic international structure, involving just one foreign trust and one underlying account, can subject a taxpayer to penalties for unreported income and unfiled Forms 3520, Forms 3520-A, Forms 8938, FBARs and more. Given the complexity of international tax rules and procedures, and given the enormity of international penalties thanks to "stacking," taxpayers involved in global disputes with the IRS would be wise to hire tax professionals specialized in this area.

ENDNOTES

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1 Code Secs. 6662, 6663.

2 Code Sec. 6621.

3 31 USC §5321(a)(5)(A).

4 31 USC §5321(a)(5)(B)(i). This penalty cannot be asserted if the taxpayer was "non-willful" and there was "reasonable cause" for the violation. *See* 31 USC §5321(a)(5)(B)(ii).

5 31 USC §5321(a)(5)(C)(i).

6 31 USC §5321(d) ("A civil penalty may be imposed under [31 U.S.C. §5321(a)] with respect to any violation of this subchapter notwithstanding the fact that a criminal penalty is imposed with respect to the same violation.").

7 Code Sec. 6048(a)(1).

8 Code Sec. 6048(a)(3)(A). The "grantor trust rules" are located in Code Secs. 671 through 679.

9 Code Sec. 6048(b)(1), after March 18, 2010; Notice 97-34, Section IV.

10 Code Sec. 6048(c)(1).

11 Notice 97-34, Section V.

12 Code Sec. 6677(a). Congress added the $10,000 minimum penalty in March 18, 2010, via Section 535(a) of the Hiring Incentives to Restore Employment ("HIRE") Act. It applied to Forms 3520 and Forms 3520-A required to be filed after December 31, 2009, pursuant to Section 535(b) of the HIRE Act.

13 Code Sec. 6677(b)(2).

14 Code Sec. 6677(a).

15 Code Sec. 6677(d); Notice 97-34, Section VII.

16 Code Sec. 6677(e).

17 *See www.irs.gov/businesses/corporations/lbi-active-campaigns*.

18 *Wilson*, DC-NY, 124 AFTR 2d 2019-6693 (2019). The author obtained from the District Court the following documents related to *Wilson* in preparing the article. Complaint filed September 4, 2019; Motion for Pre-Motion Conference and Motion for Partial Dismissal of Complaint by United States filed October 9, 2019; Plaintiffs' Opposition to the Government's Motion for Partial Dismissal of the Complaint filed October 21, 2019; Plaintiffs' Memorandum in Support of Their Cross-Motion for Partial Summary Judgment filed October 28, 2019; Defendant United States of America's Response in Opposition to Plaintiff's Cross-Motion for Partial Summary Judgment filed November 12, 2019; Memorandum Decision and Order filed November 18, 2019.

19 Code Sec. 6402(a).

20 Code Sec. 6511(a).

21 Code Sec. 6532(a)(1); Reg. §301.6532-1(a); Code Sec. 7422(a).

22 Code Sec. 6532(a)(1); Reg. §301.6532-1(a); Code Sec. 7422(a).

23 The District Court does not expand on this point, but there are numerous cases, going back nearly a century, supporting the proposition that any statutory ambiguity or doubt must be resolved in favor of the taxpayer, not the IRS. *See, e.g., Merriam*, SCt, 1 USTC ¶84, 263 US 179, 187–188, 44 SCt 69 ("On behalf of the government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with the legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer."); *Maryland Casualty Co.*, CA-7, 49 F2d 556, 558 ("[Tax] statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer. Such acts, including provisions of limitation embodied therein, are to be construed liberally in favor of the taxpayer. There must be certainty as to the meaning and scope of language imposing any tax, and doubt in respect to its meaning is to be resolved in favor of the taxpayer.") (citations omitted); *Bryson*, CA-9, 35-2 USTC ¶9556, 79 F2d 397, 402 ("It is familiar doctrine that taxing acts, including provisions of limitation embodied therein [are] to be construed liberally in favor of the taxpayer."); *Holmes Limestone Co.*, DC-OH, 97-1 USTC ¶70,068, 946 FSupp 1310, 1319 ("These rules of construction guide this court in most situations, however, materially different rules have been adopted for the interpretation of a revenue statute. '[A]s for any statute, the starting point is the words of the statute, taking the words in their ordinary meaning in the field of interest, and giving full effect to 'every word Congress used.' [However, a]s a special rule in tax cases, 'if doubt exists as to the construction of a taxing statute, the doubt should be resolved in favor of the taxpayer.'").

24 *Wilson*, DC-CT, 128 AFTR 2d 2021-XXXX (2021); *see also* Andrew Velarde, *Second Circuit Hands Government Win on Foreign Trust Penalties*, 2021 TAX NOTES TODAY FEDERAL 144-3, July 29, 2021.

25 *Wilson*, DC-CT, 128 AFTR 2d 2021-XXXX (2021), Slip Opinion, at 9 (referencing Code Secs. 6048(c), 6677(a), 6677(c)).

26 *Wilson*, DC-CT, 128 AFTR 2d 2021-XXXX (2021), Slip Opinion, at 9.

27 *Wilson*, DC-CT, 128 AFTR 2d 2021-XXXX (2021), Slip Opinion, at 11–12.

28 *Wilson*, DC-CT, 128 AFTR 2d 2021-XXXX (2021), Slip Opinion, at 12–13.

29 *Wilson*, DC-CT, 128 AFTR 2d 2021-XXXX (2021), Slip Opinion, at 13.

30 *Wilson*, DC-CT, 128 AFTR 2d 2021-XXXX (2021), Slip Opinion, at 13–16.

31 *Wilson*, DC-CT, 128 AFTR 2d 2021-XXXX (2021), Slip Opinion, at 16–17.

32 *Garrity et al*, DC-CT, Case No. 3:15-cv-243 (2018). The author obtained and reviewed the

following documents pertaining to this case in preparing this article: Complaint and Jury Demand filed February 20, 2015; Defendant's Answer and Affirmative Defenses filed April 24, 2015; Expert Report by Howard B. Epstein, CPA dated April 28, 2017; Memorandum and Order regarding Standard of Proof filed April 3, 2018; Plaintiff's Motion in Limine to Exclude the Testimony of Howard B. Epstein filed April 3, 2018; Plaintiff's Memorandum in Support of Its Motion in Limine to Exclude Opinion Testimony of Howard B. Epstein filed April 3, 2018; Defendant's Opposition to Plaintiff's Motion in Limine to Exclude Opinion Testimony of Howard B. Epstein filed April 24, 2018; Joint Trial Memorandum filed May 4, 2018; Stipulation regarding Determination of Factual and Legal Issues filed May 30, 2018; and Memorandum and Order regarding Proposed Expert Testimony of Howard B. Epstein filed June 1, 2018; Jury Instructions filed June 12, 2018; Verdict Form filed June 13, 2018; Judgment filed June 13, 2018.

33 *P.G. Garrity et al. Est*, Tax Court Docket No. 006561-12. The Petition was filed in March 2012 and the Stipulated Decision was entered in June 2019.

34 *Garrity et al*, DC-CT, Case No. 3:15-cv-243. Defendants' Motion to Alter and Reduce Judgment filed July 11, 2018, at 17.

35 *Garrity et al*, DC-CT, Case No. 3:15-cv-243. Plaintiff United States' Response in Opposition to Defendants' Motion to Alter and Reduce Judgment filed August 1, 2018, at 39.

36 *Garrity et al*, DC-CT, Case No. 3:15-cv-243. Plaintiff United States' Response in Opposition to Defendants' Motion to Alter and Reduce Judgment filed August 1, 2018, at 39.

37 *Garrity*, DC-CT, 123 AFTR 2d 2019-941 (2019).

38 *Garrity*, DC-CT, 123 AFTR 2d 2019-941 (2019).

39 *Garrity et al*, DC-CT, Case No. 2:18-cv-00111. The author obtained and reviewed the following documents pertaining to this case in preparing the article: Complaint filed January 18, 2018; Defendant's Answer and Affirmative Defenses filed February 26, 2018; Stipulation for Dismissal dated January 28, 2019.

40 *Garrity et al*, DC-CT, Case No. 2:18-cv-00111. Defendant's Answer and Affirmative Defenses filed February 26, 2018.

41 *Garrity et al*, DC-CT, Case No. 2:18-cv-00111. Defendant's Answer and Affirmative Defenses filed February 26, 2018.

42 *Garrity et al*, DC-CT, Case No. 2:18-cv-00111. Stipulation for Dismissal dated January 28, 2019.

43 *P.G. Garrity, Sr. Est*, Case No. 08-0211 (Saybrook, Conn. Probate Court) (filed March 3, 2008).

44 *Garrity et al*, DC-CT, Case No. 3:15-cv-243. Defendants' Motion to Alter and Reduce Judgment filed July 11, 2018, at 17.