International Tax Disputes: Recent Cases Show Ways Taxpayers Give the IRS Forever to Audit, Tax, and Penalize

*By Hale E. Sheppard**

I. Introduction

In life, and in international tax disputes, timing can be everything. Many taxpayers with foreign activities know this, and they attempt to use it to their advantage. The key is that the Internal Revenue Service ("IRS") normally needs to identify the non-compliance within a short timeframe, which can be tricky if the relevant matters occurred abroad. Taxpayers who have failed to properly report worldwide income and assets, either accidentally or on purpose, hope that the proverbial clock runs out before the IRS can take action. This sometimes happens in purely domestic cases, but much less often in the international context. This article, using several recent Tax Court cases as a springboard, examines three tools at the IRS's disposal for expanding assessment periods against taxpayers when international transgressions are involved.

II. International Duties and Downsides

To understand the importance for taxpayers of keeping the assessment period as short as possible, one must first understand common duties triggered by owning foreign assets, along with the sanctions for disobeying them.

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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 the 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*), or Forms 3520 (*Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*), depending on the classification of the entities; and
- 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

Many articles supply enormous detail on the severity of civil penalties for international non-compliance. For purpose of this article, the following overview suffices.

First, taxpayers who omit income from foreign activities and assets often face large U.S. tax liabilities, as well as significant penalties directly tied to such liabilities. Examples include negligence penalties equal to 20 percent of the tax debt to the IRS, 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, accumulating without mercy, on both the tax liabilities and penalties.[2]

Second, 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]

Third, if a taxpayer fails to file a proper Form 8938, then the IRS generally will assert a penalty of $10,000 per violation.[7] The penalty increases to a maximum of $50,000 if the taxpayer does not rectify the problem quickly after contact from the IRS.[8]

Fourth, holding an interest in a foreign corporation triggers yet more complications. Several categories of U.S. persons who are officers, directors, and/or shareholders of certain foreign corporations ordinarily must file a Form 5471 with the IRS.[9] If a person neglects to do so, then the IRS may assert a penalty of $10,000 per violation, per year.[10] This standard penalty can jump to $50,000, if the problem persists after the IRS notifies the taxpayer.[11]

Fifth, additional penalties apply when foreign trusts are involved. A "responsible party" generally must file a Form 3520 within 90 days of certain "reportable events." These include the creation of a foreign trust by a U.S. person, the transfer of 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 trust under the grantor trust rules, or if any portion of the foreign trust was included in the person's gross estate.[12] A U.S. person also must file a Form 3520 if he receives any distribution from a foreign trust during a year.[13] The penalty for Form 3520 violations is either $10,000 or 35 percent of the so-called "gross reportable amount," whichever is larger.[14]

C. Summary

As demonstrated above, the IRS can impose income taxes and serious penalties on taxpayers, with links abroad, who fail to comply. Taxpayers caught by the IRS employ various defense strategies. One tactic is challenging the character, timing and/or amount of unreported income in an effort to reduce income taxes. Another is arguing that the IRS should waive or mitigate penalties because the taxpayer had "reasonable cause" for the violation. While focusing on ways to avoid more taxes and penalties, many taxpayers overlook a key issue, the applicable assessment period. This concept is pivotal because every additional year to which the IRS has access means the potential imposition of more taxes, penalties, and interest against the taxpayer.

III. Three Techniques for Expanding Assessment Periods

The IRS, ever mindful of the financial benefits it can derive from expanding an assessment period, frequently attempts to do so in the international context using the three techniques examined below.

A. Technique 1—Unfiled or Improper International Information Returns

Among the IRS's favorite weapons is its ability to lengthen the assessment period when taxpayers neglect to submit international information returns.

1. Overview of Code Sec. 6501(c)(8)

The general rule is that the IRS has three years from the time a taxpayer files a tax return to identify it as problematic, conduct an audit, offer all required administrative procedures, and issue a final notice proposing adjustments.[15] There are various exceptions to the normal three-year rule. One exception, found in Code Sec. 6501(c)(8), applies to situations where a taxpayer fails to file information returns about foreign entities, transfers, or assets.[16] This tax provision states the following:

> In the case of any information which is required to be reported [to the IRS pursuant to various international tax provisions], the time for assessment of any tax imposed by [the Internal Revenue Code] *with respect to any tax return, event, or period to which such information relates* shall not expire before the date which is 3 years after the date on which the [IRS] is furnished the information required to be reported …[17]

Unpacking this a little, Code Sec. 6501(c)(8) provides that, if a taxpayer does not file a required international information return, such as a Form 8938 or Form 5471, then the assessment period never starts to run. The IRS has an endless opportunity to audit not only the unfiled international information returns, but the tax returns to which they should have been attached in the first place. Code Sec. 6501(c)(8) essentially prevents taxpayers with international non-compliance from running out the clock with the IRS.

2. Broad Interpretation by Congress

Congress has adopted a broad interpretation of a "related" tax return, event, or period. For instance, the legislative history indicates that the taxes and penalties asserted by the IRS during the extended assessment period under Code Sec. 6501(c)(8) are *not* limited to items related to the data that should have been reported on an international information return. The legislative history states the following in this regard:

> Section 6501(c)(8) provides an exception to the three-year period of limitations due to failures to provide information about cross-border transactions or foreign assets. Under this exception … the limitation period for assessment of tax does not expire any earlier than three years after the required information about certain cross-border transactions or foreign assets is actually provided to the [IRS] by the person required to file the return. In general, such information reporting is due with the taxpayer's return; thus, the three-year limitation period commences when a timely and complete return (including all information reporting) is filed. Without the inclusion of the information reporting with the return, the limitation period does not commence until such time as the information reports are subsequently provided to the [IRS], even though the return has been filed. *The taxes that may be assessed during this suspended or extended period are not limited to those attributable to adjustments to items related to the information required to be reported by one of the enumerated sections.*[18]

Another portion of the legislative history clarifies just how expansively the IRS should construe the notion of "related items" when it comes to arguing for longer assessment periods. It states that "related items" include: (i) proposed tax adjustments to Forms 1040 with respect to the items that should have been disclosed on an international information return enclosed with Forms 1040, (ii) proposed adjustments to any item, to the extent that it is affected by the item not properly revealed on an international information return, and (iii) penalties and interest related to either of the preceding two adjustments.[19]

3. Guidance from the IRS

The IRS, for its part, has issued internal guidance about Code Sec. 6501(c)(8) in various forms, a few of which are examined below.

The IRS issued a memorandum to its staff clarifying the scope of Code Sec. 6501(c)(8). It concluded that the extended assessment period "applies to the entire return and not only to the tax deficiency attributable to the information which was not reported, unless the failure to provide the required information is due to reasonable cause and not willful neglect."[20]

A few years later, the IRS released an International Practice Unit ("IPU") supplying IRS personnel with specific instructions in situations where Form 5471 violations are present. The IPU tells Revenue Agents that if they identify unfiled Forms 5471 for the years under audit, they should consider expanding the audit to encompass earlier years. The IPU also underscores that Code Sec. 6501(c)(8) holds the assessment period open indefinitely, not only when a taxpayer fails to file a Form 5471, but also when a taxpayer filed a timely but "substantially incomplete" one. The IPU emboldens IRS personnel to advance the argument that the assessment period expires only after a taxpayer files a "substantially complete" Form 5471; ones with major errors or omissions will not suffice.[21]

In addition, the IRS issued a Program Manager Technical Advice ("PMTA") addressing extension of assessment periods under Code Sec. 6501(c)(8) in a situation where the executor of an estate failed to file a Form 8938 for the deceased.[22] The main facts in the PMTA are as follows. The taxpayer, a U.S. person, held an interest in various foreign financial assets, the value of which exceeded the relevant filing threshold for Form 8938. The taxpayer died in Year 1. Generally, the executor of an estate has three main filing duties: (i) File a Form 1040 for the decedent for the short year, running from January 1 through the date of death; (ii) File a Form 1041 (*U.S. Income Tax Return for Estates and Trusts*) for the estate for the short year, running from the date of death until December 31, as well as all subsequent years until the estate is closed; and (iii) File a Form 706 (*U.S. Estate and Generation-Skipping Transfer Tax Return*) for the estate, if necessary. In the PMTA, the executor filed a Form 1040, Form 1041, and Form 706 without contemplating the foreign assets. The executor forgot to enclose a Form 8938 with the Form 1040, too.

A considerable portion of the PMTA focused on whether information that should have been provided to the IRS on Form 8938 (or any other relevant international information return) "relates" to a tax return, event, or period. The IRS stated the following in this regard:

> Whether information "relates" to a specific "return, event, or period" will generally require a case-specific inquiry. However, in many cases, the failure of an executor to report a foreign financial asset [on Form 8938] … will hold open the period of limitations on assessment of any tax required to be shown on the individual's Form 1040 or the estate's Form 1041 or Form 706, to the extent that the unfurnished information "relates" to such return.

The IRS then applied its interpretation of Code Sec. 6501(c)(8) to the facts in the PMTA. The IRS provided the following explanation as to why the unfiled Form 8938 yielded an indefinite assessment period for the Form 1040, Form 1041 and Form 706, even though Form 8938 was only required to be filed with one return (*i.e.*, Form 1040), and even though there was no evidence that the executor intentionally or willfully did anything wrong:

> The information required to be reported [on Form 8938] would have helped the [IRS] to identify each of these omitted items. At the very least, the information would have identified a likely source of income, during the relevant time period, and assets held at or near the time of death. *On these facts, it seems clear that the unfurnished information [that should have been reported to the IRS on Form 8938] would relate to each of these three returns because it identified a source of income reportable on the Form 1040 and the Form 1041 and an item which should have been included in the gross estate on the Form 706.*

4. Practical Application by the Tax Court

A recent Tax Court case, *Kelly*, addressed the role of Code Sec. 6501(c)(8) in a situation involving unfiled Forms 5471.[23] The taxpayer in this case ran many businesses, which often shifted funds back and forth, depending on availability. The taxpayer generally characterized these amounts as "loans" to affiliated entities, adhering to the bookkeeping and accounting practices implemented by various officers and outside accountants. As his operations grew and diversified, the taxpayer formed a considerable number of domestic single-member limited liability companies, which were treated as disregarded entities for tax purposes. Thus, instead of filing separate tax returns for such domestic entities, each was reported on a separate Schedule C (Profit or Loss from Business) attached to the taxpayer's annual Form 1040.

In 2008, the taxpayer formed a foreign corporation ("Caribbean Corporation") for purposes of buying a commercial yacht from a distressed seller at a discounted price. The taxpayer was the sole owner of the Caribbean Corporation. The business plan consisted of renovating the yacht and then selling it at a profit or chartering it to generate an income stream. It appears that this was the only foreign entity owned by the taxpayer.

The taxpayer had a longstanding professional relationship with an outside, independent accounting firm, working with them since 2000 ("Accounting Firm"). The Controller for various companies owned by the taxpayer timely sent to the Accounting Firm all tax-related data, including data about the Caribbean Corporation. In doing so, the Controller sent an email to the Accounting Firm expressly stating that the Caribbean Corporation was a foreign entity, the taxpayer was the sole owner, he was unsure about which U.S. filing requirements applied, and the Caribbean Corporation would need to be addressed starting in 2008. Despite this email, the Accounting Firm treated the Caribbean Corporation as a *domestic* disregarded entity, reporting it on a Schedule C, and did not file a Form 5471.

The IRS started an audit, identified potential problems in multiple years, issued a Notice of Deficiency in 2016 proposing adjustments to Forms 1040 going all the way back to 2007, and raised various theories for ignoring the normal three-year assessment period. Among them was that the unfiled Forms 5471 in earlier years related to the Caribbean Corporation allowed the IRS to reach back nearly a decade under Code Sec. 6501(c)(8).

The Tax Court was not receptive to the IRS's arguments on this issue. It acknowledged that the taxpayer did not file timely Forms 5471 for 2008 and 2009, but warned that the IRS could only make adjustments related to the Caribbean Corporation (and not related to anything else on Forms 1040) if there was "reasonable cause" for the taxpayer's non-compliance. The Tax Court pointed out that both the Supreme Court and Tax Court have previously accepted reasonable reliance on tax professionals as "reasonable cause" under certain circumstances.[24]

The Tax Court emphasized the following facts: the Accounting Firm had been preparing the taxpayer's Forms 1040 since 2000, including Schedules C for his many companies; the relevant accountants at the Accounting Firm had no prior adverse disciplinary actions or IRS penalties; the accountants had decades of experience preparing Forms 1040; the taxpayer timely notified the Accounting Firm about the Caribbean Corporation, its foreign status, and its ownership; the Accounting Firm did not have a conflict of interest; and the situation did not involve some tax or financial result that was "too good to be true." Ultimately, the Tax Court held in favor of the taxpayer, ruling that he had "reasonable cause" for not filing timely Forms 5471 for 2008 and 2009, and the IRS could only make adjustments concerning the Caribbean Corporation for such years.

B. Technique 2—Substantial Income Omissions Tied to Foreign Assets

The preceding segment addressed the IRS's ability to expand the assessment period indefinitely where taxpayers file late or improper international information returns. The IRS also has the power to enlarge the assessment period because of unreported income problems.

1. Effect of Unreported Income

Code Sec. 6501(e)(1)(A) states that, if: (i) a taxpayer omits income from a tax return, *and either* (ii) such omitted income exceeds 25 percent of the gross income that the taxpayer actually reported on the tax return, *or* (iii) such omitted income is more than $5,000 *and* is attributable to one or more foreign financial assets that must be disclosed on Form 8938, then the IRS can assess income taxes within six years of the time that the taxpayer files the relevant tax return.[25] The primary consequence of this provision is that relatively minor amounts of omitted income can keep the assessment period open a full six years, instead of the normal three. It takes little to reach a threshold of $5,000 in today's economy.

The IRS has provided several examples of instances in which taxpayers will be subject to scrutiny for six years, including the following:

> Taxpayer filed his 2005 federal income tax return on or before April 15, 2006. The return contains a more-than-25-percent omission of income, including an omission of more than $5,000 of income attributable to a foreign financial asset. Because the statute of limitations is six years from the filing date of the return for both the "more-than-25-percent omission of income" and the "omission of more than $5,000 of income attributable to a foreign financial asset," the statute of limitations will not expire before April 15, 2012 …[26]

2. Positions by IRS in Tax Court Case

In *Rafizadeh*, the IRS took an extreme position, attempting to use Code Sec. 6501(e)(1)(A) to reach tax liabilities stemming from unreported foreign accounts during years before that provision even took effect.[27]

a. Relevant Facts. The taxpayer filed timely Forms 1040 for 2006, 2007, 2008, and 2009, by April 15 of the relevant years. There was one big problem, at least as far as the IRS was concerned: The taxpayer failed to report on such Forms 1040 the passive income (*i.e.*, dividends, interest, and capital gains) earned by his account at Union Bank of Switzerland ("UBS"). The IRS served a John Doe Summons on UBS on July 21, 2008, and the taxpayer was one of the individuals with respect to whose tax liability the Summons was issued. UBS did not comply with the Summons initially, but this matter was finally resolved on November 16, 2010.

Four years later, in December 2014, the IRS issued a Notice of Deficiency to the taxpayer, alleging tax liabilities and penalties. The taxpayer disputed the allegations by filing a Petition with the Tax Court. His primary contention was that the proposed taxes were groundless because the relevant assessment periods had expired before the IRS issued the Notice of Deficiency. If no tax liabilities exist, then the proposed penalties disappear, too, the taxpayer argued. The IRS filed an Answer with the Tax Court rejecting these contentions, the taxpayer countered with a Reply, and, ultimately, the taxpayer filed a Motion for Summary Judgment.

The battle focused on the effective date of Code Sec. 6501(e)(1)(A). The law expressly stated that it would apply to: (i) returns filed after March 18, 2010, and (ii) returns filed on or before March 18, 2010, provided that the normal assessment period had not expired for such returns by that date.[28]

b. Main Positions of the Parties. The IRS advanced the following syllogism. Code Sec. 6501(e)(1)(A) took effect on March 18, 2010, at which time the general three-year assessment periods were still open with respect to the taxpayer's Forms 1040 for 2006, 2007, and 2008. Because the assessment periods were still open on that date, the six-year assessment period under Code Sec. 6501(e)(1)(A) applies, regardless of the fact that the taxpayer did not even have a legal duty until 2011 to file a Form 8938 reporting foreign financial assets. Using the six-year assessment period, coupled with the suspension of the running of the assessment periods for 664 days during the pendency of the John Doe Summons to UBS, the assessment periods for 2006, 2007, and 2008 were still open when the IRS issued the Notice of Deficiency in December 2014.

c. Decision by the Tax Court. The Tax Court identified the root of the confusion, conducted a statutory interpretation exercise, and then determined that the IRS had issued its Notice of Deficiency too late. The Tax Court explained that a natural reading of the relevant provisions indicates that the IRS can only utilize the expanded six-year assessment period during years where taxpayers had a legal obligation to file Forms 8938 disclosing foreign financial assets. This duty began in 2011, yet the Forms 1040 attacked by the IRS in *Rafizadeh* pertained to 2006, 2007, 2008, and 2009.[29]

C. Technique 3—Claims of Civil Fraud

The third tactic utilized by the IRS, in both international and domestic disputes, is to allege that the taxpayer engaged in civil fraud.

1. Relevant Tax Provisions

As indicated above, the IRS generally has three years from the date on which a taxpayer files a return to assess additional taxes, penalties and interest related to such return.[30] This three-year period may be extended in certain situations. For instance, if a taxpayer files a false or fraudulent return with intent to evade tax, then the IRS may assess tax at any time.[31]

2. Overview of Fraud Standards

The IRS must establish, by clear and convincing evidence, that there is a tax underpayment, and such underpayment is attributable to fraud.[32] Fraudulent intent is determined at the time a taxpayer signs a tax return with the intention of filing it, or when the return is actually filed.[33] Thus, the fraud penalty cannot be sustained if no fraudulent intent existed at one of these critical points, even if the taxpayer *later* acquired knowledge of the falsity of the return.[34] Courts have repeatedly refused to uphold fraud penalties where post-filing events, such as contact by the IRS, created a taxpayer's awareness that an earlier return was incorrect.[35]

The Internal Revenue Manual describes the high standard that the IRS must meet. It needs to demonstrate the requisite intent of the taxpayer, which "is distinguished from inadvertence, reliance on incorrect technical advice, honest difference of opinion, negligence, or carelessness."[36]

Each allegation of fraud is decided on its own particular facts, and no single factor is decisive. Factors, or "badges," that courts have cited as indications of fraud include: (i) understatement of income, (ii) inadequate records, (iii) failure to file tax returns, (iv) implausible or inconsistent explanations of behavior, (v) fictitious transactions and entities, (vi) concealment of assets, (vii) failure to cooperate with tax authorities, (viii) engaging in illegal activities, (ix) attempting to conceal illegal activities, (x) dealing in cash, and (xi) not making estimated tax payments.[37]

The taxpayer's level of sophistication is another relevant factor in determining fraud. Some courts have declined to impose fraud penalties on relatively sophisticated taxpayers who were uninformed about tax law. *Graves* illustrates the concept.[38] In that case, a husband and wife were both college graduates. The husband was a stockbroker, while the wife worked as an assistant in a brokerage firm. Both were financially sophisticated individuals. They improperly deducted "contributions" to a "charitable foundation," which they used to pay the private school tuition of their children. They did not conceal the nature of the contributions, either from their accountant or from the IRS during audit, nor did they display any other badges of fraud. Under these circumstances, their financial sophistication, coupled with failure to investigate, did *not* rise to the level of fraud.

3. Newest Tax Court Case

A very recent Tax Court case, *Harrington*, is an international tax matter that turns on the appropriate assessment period.[39] More specifically, the dispute centers on whether the taxpayer engaged in civil fraud, such that the assessment period was endless, or whether he did not, and the normal three-year assessment period applied.

The taxpayer worked in the forest products industry, eventually taking over management of a struggling Canadian company that exported lumber to Europe ("Canadian Company"). The attorney for the Canadian Company ("Local Counsel") explained to the taxpayer that he had structured matters to minimize taxes for the owners of the Canadian Company. These maneuvers included establishing an entity in the Cayman Islands to handle operational and financial matters ("Cayman Company"), as well as an underlying account in Malta ("Malta Account").

The taxpayer sold his house at some point in the 1980s and gave $350,000 of the proceeds to Local Counsel, supposedly as a "loan" to the Canadian Company. Following a familiar pattern, Local Counsel opened an account in Switzerland ("Swiss Account") in the name of a pre-existing entity in the Cayman Islands ("Second Cayman Company"). The Tax Court indicated that there was no loan agreement, promissory note, or other evidence that the transfer of funds constituted a "loan."

The Canadian Company ceased operations around 1993. It appears that the entire structure was disbanded more than a decade later, in 2007. The Cayman Company and Second Cayman Company were dissolved, and the corresponding Malta Account and Swiss Account were closed. A portion of these funds, allocated to the taxpayer, was sent to a "conduit account" at UBS. Allegedly on the advice of UBS bankers, taxpayer agreed to the formation of a trust-like entity in Liechtenstein ("Liechtenstein Trust") with a corresponding account in Switzerland ("Second Swiss Account").

Two years later, in 2009, UBS closed the Second Swiss Account pursuant to its deferred-prosecution agreement with the U.S. government. The taxpayer, apparently relying on advice from a Swiss attorney, then contributed the funds from the Second Swiss Account to life insurance policies in Liechtenstein. His wife and children were beneficiaries of such policies.

In 2013, the taxpayer canceled the life insurance policies and moved the funds to a new account with a bank in Liechtenstein ("Liechtenstein Account"). It was held in the name of the taxpayer's wife because the bank would not accept U.S. clients.

The taxpayer prepared his own Forms 1040 for the years at issue, 2005 through 2010. He did not report on such Forms 1040 the income generated by the foreign entities, accounts or policies described above. The taxpayer filed timely FBARs for the relevant years, disclosing small accounts in New Zealand where he was living at the time, yet omitting large accounts in the Cayman Islands, Switzerland, and Liechtenstein. The taxpayer did not file Forms 3520 related to the Liechtenstein Trust.

The IRS started an audit in 2012. The documentation that the IRS obtained in connection with the audit revealed that the taxpayer: (i) was the beneficial owner of the Swiss Account, (ii) a beneficiary of the Liechtenstein Trust, (iii) communicated with UBS bankers by telephone, email, and in person, (iv) received copies of account statements regularly, (v) was involved in making decisions about investments, transfers, entities, *etc.*, and (vi) failed to report to the IRS about $792,000 of income over the relevant years. During the audit, the taxpayer made false statements to the Revenue Agent, first claimed that he made a "loan" to the Canadian Company and later suggested that his former business associates "stole" his money, contended that he had no control over the foreign entities, accounts or policies, and maintained that UBS took many of the actions unilaterally and without his knowledge.

In April 2018, the IRS issued a Notice of Deficiency related to Forms 1040 for 2005 through 2010, asserting additional income taxes and civil fraud penalties. The taxpayer disputed the Notice of Deficiency by filing a Petition with the Tax Court.

Timing is key in this case. Applying the general three-year rule, the assessment period for all relevant years, 2005 through 2010, would have expired several years *before* the IRS issued its Notice of Deficiency, thereby rendering the IRS out of luck. However, if civil fraud existed, then the IRS faced no temporal restrictions; it was free to issue its Notice of Deficiency in April 2018 or any other time.

The Tax Court turned to the so-called "badges of fraud" in the case. Several were inapplicable, but the Tax Court determined that the taxpayer had a pattern of significantly understating income on his Forms 1040, failed to maintain adequate records of foreign activities, gave the Revenue Agent and the Tax Court implausible and inconsistent explanations, engaged in "a paradigm of asset concealment," did not cooperate during the audit, and filed multiple false documents with the IRS. Because the IRS managed to prove, by clear and convincing evidence, that the taxpayer committed fraud, the Tax Court held that the assessment periods for the relevant years were endless, the Notice of Deficiency was timely, and the taxpayer owed significant income taxes, fraud penalties, and interest.[40]

IV. Conclusion

This article demonstrates that, along with the normal concerns in a dispute with the IRS, taxpayers with international violations face an additional threat: The potential for extended or indefinite assessment periods in situations involving unfiled international information returns, unreported income from foreign sources, and/or civil fraud. These issues are obscure and complicated, and failure to adequately defend against them can lead to disastrous results for taxpayers. The IRS understands that time is money, in the form of more taxes, penalties, and interest as the audit period grows. Taxpayers with international reach should have a healthy appreciation of this reality, too.

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 USC §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. 6038D(d)(1); Reg. §1.6038D-8(a).

[8] Code Sec. 6038D(d)(2); Reg. §1.6038D-8(c).

[9] Code Sec. 6038; Reg. §1.6038-2; Code Sec. 6046; Reg. §1.6046-1; Code Sec. 6679; Reg. §301.6679-1; Instructions to Form 5471.

[10] Code Sec. 6038(b)(1); Reg. §1.6038-2(k)(1)(i); Code Sec. 6046(f); Reg. §1.6046-1(k).

[11] Code Sec. 6038(b)(2); Reg. §1.6038-2(k)(1)(ii); Code Sec. 6046(f); Reg. §1.6046-1(k).

[12] Code Secs. 6048(a)(1); 6048(a)(4).

[13] Code Sec. 6048(c)(1).

[14] Code Sec. 6677(a).

[15] Code Sec. 6501(a).

[16] Code Sec. 6501(c)(8).

[17] P.L. 111-147 (Mar. 18, 2010), Title V, Subtitle A, Parts I through V, §511(b) (emphasis added).

[18] 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. Aug. 10, 2010, p. 36 (emphasis added); *See also* U.S. Joint Committee on Taxation. *Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the "Hiring Incentives to Restore Employment Act."* JCX-4-10. Feb. 23, 2010, p. 66 (emphasis added).

[19] 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. Aug. 10, 2010, p. 37. *See also* Chief Counsel Advisory 201147030 (Nov. 25, 2011).

[20] IRSIG SBSE-25-0312-022 (Mar. 9, 2012) (emphasis added).

[21] "Failure to File the Form 5471—Category 4 and 5 Filers—Monetary Penalty." International Practice Unit (updated as of Oct. 7, 2015).

[22] IRS Program Manager Technical Advice 2014-018 (2015).

[23] *Kelly*, 121 TCM 1561, Dec. 61,888(M), TC Memo. 2021-76.

[24] *Kelly*, 121 TCM 1561, Dec. 61,888(M), TC Memo. 2021-76, pp. 48–49 (referencing *Boyle*, SCt, 85-1 USTC ¶13,602, 469 US 241, 246, 105 SCt 687, *Flume*, 113 TCM 1097, Dec. 60,822(M), TC Memo. 2017-21, and *Neonatology Associates, P.A.*, 115 TC 43, Dec. 53,970 (2000), *aff'd*, CA-3, 2002-2 USTC ¶50,550, 299 F3d 221).

[25] Code Sec. 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), pp. 64–66; P.L. 111-147, Hiring Incentives to Restore Employment Act, §513(d), Mar. 18, 2010.

[26] IRSIG SBSE-25-0312-022 (Mar. 9, 2012).

[27] The author derived information about the case from various documents filed with or by the Tax Court, including the Answer filed Apri1 8, 2015, Redacted Petition filed April 13, 2015, Reply to Answer filed June 12, 2015, Petitioner's Motion for Summary Judgment filed July 13, 2015, Respondent's Response to Petitioner's Motion for Summary Judgment filed September 7, 2015, Petitioner's Response to Respondent's Response to Petitioner's Motion for Summary Judgment filed September 30, 2015, and *Rafizadeh*, 150 TC 1 (2018).

[28] P.L. 111-147, Hiring Incentives to Restore Employment Act, §513(c), Mar. 18, 2010.

[29] *Rafizadeh*, 150 TC 1 (2018), pp. 7–8. The IRS raised this same aggressive position regarding assessment periods in other cases, too. However, the IRS conceded this line of attack before trial after receiving the unfavorable decision *Rafizadeh*. *See Toso*, 151 TC 27 (2018), footnote 2.

[30] Code Sec. 6501(a).

[31] Code Sec. 6501(c)(1).

[32] Code Sec. 7454(a); Tax Court Rule 142(b); Code Sec. 6663.

[33] *Merritt*, CA-5, 3011 F2d 484, 487; *Wilson*, 76 TC 623, Dec. 37,841 (1981); *Coleman*, 56 TCM 710, Dec. 45,182(M), TC Memo. 1988-538.

[34] *Piekos*, 44 TCM 1401, Dec. 39,426(M), TC Memo. 1982-602; *Broadhead*, 14 TCM 1284, Dec. 21,392(M), TC Memo. 1955-328.

[35] *See, e.g., Comparato*, 65 TCM 1890, Dec. 48,860(M), TC Memo. 1993-52.

[36] IRM §20.1.5.12.2 (Jan. 10, 2005).

[37] *Meier*, 91 TC 273, Dec. 44,995 (1988). *See also Toushin*, CA-7, 2000-2 USTC ¶50,646, 223 F3d 642; *Bradford*, CA-9, 86-2 USTC ¶9602, 796 F2d 303; *Hicks Co.*, 56 TC 982, Dec. 30,920 (1971).

[38] *Graves*, 68 TCM 1445, Dec. 50,293(M), TC Memo. 1994-616; *See also Gow*, 79 TCM 1680, Dec. 53,805(M), TC Memo. 2000-93.

[39] *Harrington*, 122 TCM 116, Dec. 61,908(M), TC Memo. 2021-95.

[40] The Tax Court clarified that a portion of the tax underpayment in 2007 related to domestic matters and was not attributable to fraud. It further held that the taxpayer did not have a tax underpayment in 2010, as a result of which the assessment-period for 2010 had expired before the IRS issued the Notice of Deficiency. *See Harrington*, 122 TCM 116, Dec. 61,908(M), TC Memo. 2021-95.