Mukhi v. Commissioner, 163 T. C. No. 8 (U. S. Tax Court 2024)

In Mukhi v. Commissioner, the U. S. Tax Court ruled that the IRS lacks statutory authority to assess penalties under I. R. C. § 6038(b)(1) for failure to file Forms 5471. The court reaffirmed its stance despite a contrary decision by the D. C. Circuit in Farhy v. Commissioner, emphasizing the unambiguous text of the statute. This ruling prevents the IRS from collecting these penalties via liens or levies, significantly impacting how the IRS can enforce information reporting requirements related to foreign corporations.

Parties

Raju J. Mukhi, Petitioner, was represented by Sanford J. Boxerman and Michelle F. Schwerin. The Commissioner of Internal Revenue, Respondent, was represented by Randall L. Eager, Alicia H. Eyler, and William Benjamin McClendon.

Facts

Between November 2001 and September 2005, Raju J. Mukhi created three foreign entities, including Sukhmani Partners II Ltd. , a foreign corporation for U. S. tax purposes. Mukhi failed to timely file Forms 5471, Information Return of U. S. Persons With Respect To Certain Foreign Corporations, from tax year 2002 through 2013 to disclose his ownership interest in this foreign corporation. After Mukhi pleaded guilty to criminal tax violations for subscribing to false U. S. individual income tax returns and willful failure to file reports of foreign bank and financial accounts, the IRS began an examination for Mukhi's liability for civil tax penalties. During the examination, Mukhi filed under protest Forms 5471. At the conclusion of the examination, the IRS assessed $120,000 in penalties under I. R. C. § 6038(b)(1) for failure to timely file Form 5471 for tax years 2002 through 2013. The IRS issued notices proposing a levy and filed a lien notice to collect the unpaid penalties, prompting Mukhi to request a collection due process hearing under I. R. C. §§ 6320 and 6330. After the hearing, the IRS issued a notice of determination sustaining the collection actions. Mukhi filed a petition with the U. S. Tax Court challenging the IRS's authority to assess these penalties.

Procedural History

The U. S. Tax Court initially granted summary judgment in Mukhi's favor in Mukhi v. Commissioner, No. 4329-22L, 162 T. C. (Apr. 8, 2024), relying on its prior decision in Farhy v. Commissioner, 160 T. C. 399 (2023), which held that the IRS lacked authority to assess I. R. C. § 6038(b)(1) penalties. Subsequently, the U. S. Court of Appeals for the D. C. Circuit reversed the Tax Court's decision in Farhy, determining that the I. R. C. § 6038(b)(1) penalty is assessable. Farhy v. Commissioner, 100 F. 4th 223 (D. C. Cir. 2024). The IRS filed a motion for reconsideration of the Tax Court's holding regarding the I. R. C. § 6038(b)(1) penalties in Mukhi's case. The Tax Court granted the motion for reconsideration but reaffirmed its original holding

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that the IRS lacks statutory authority to assess the I. R. C. § 6038(b)(1) penalty.

Issue(s)

Whether the IRS has statutory authority to assess penalties under I. R. C. § 6038(b)(1) for failure to file Forms 5471?

Rule(s) of Law

The IRS's authority to assess certain liabilities is derived from I. R. C. § 6201(a), which authorizes and requires the IRS to assess "all taxes (including interest, additional amounts, additions to the tax, and assessable penalties)" imposed by the Code. I. R. C. § 6038(b)(1) imposes a penalty of $10,000 for each tax year for which a U. S. person does not file the required information return. The plain meaning of assessable penalties, as used in I. R. C. § 6201(a), is a necessarily more limited definition than all penalties because it imposes an additional condition. In the absence of a specified mode of recovery, the default rule of 28 U. S. C. § 2461(a) applies, which provides that a civil penalty prescribed for the violation of an Act of Congress without specifying the mode of recovery may be recovered in a civil action.

Holding

The U. S. Tax Court held that the IRS lacks statutory authority to assess the penalty under I. R. C. § 6038(b)(1) for failure to file Forms 5471. Consequently, the IRS may not proceed with the collection of these penalties from Mukhi via the lien or the proposed levy.

Reasoning

The Tax Court's reasoning was grounded in the unambiguous text of the statute. The court rejected the IRS's argument that I. R. C. § 6201(a) authorizes the assessment of all exactions found in the Code, emphasizing that the term "assessable penalties" in the statute denotes a more limited scope of assessment authority. The court highlighted the absence of text in I. R. C. § 6038(b)(1) that expressly authorizes the IRS to assess the penalty or sets forth the procedure for collection. The court compared the text of I. R. C. § 6038(b)(1) to other civil penalty statutes, which clearly indicate that the IRS may assess the penalties. The court also addressed the D. C. Circuit's reversal in Farhy, noting that the Eighth Circuit, where an appeal would presumptively lie, has not yet issued a precedential opinion on the assessability of the I. R. C. § 6038(b)(1) penalty. The court rejected policy arguments advanced by the IRS and the D. C. Circuit, including the administrative burden of collecting the penalty through a civil action and the potential deterrent effect of the penalty. The court concluded that the IRS's authority to assess must be clearly granted by Congress, and the text of I. R. C. § 6038(b)(1) does not provide such authority.

Disposition

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The U. S. Tax Court reaffirmed its prior holding that the IRS may not proceed with the collection of the I. R. C. § 6038(b)(1) penalties from Mukhi via the proposed collection actions.

Significance/Impact

Mukhi v. Commissioner has significant implications for the enforcement of information reporting requirements related to foreign corporations. The decision clarifies that the IRS must pursue civil actions in district courts to collect penalties under I. R. C. § 6038(b)(1), rather than relying on administrative assessment and collection methods. This ruling may impact the IRS's ability to efficiently enforce compliance with these reporting obligations, as it requires a more resource-intensive process for penalty collection. The decision also underscores the importance of clear statutory language in defining the IRS's authority, potentially influencing future interpretations of similar penalty provisions in the Internal Revenue Code. The Tax Court's adherence to its precedent, despite the D. C. Circuit's contrary decision, highlights the court's commitment to its role in providing uniformity in tax law and its willingness to maintain its interpretation until a higher court decides otherwise.

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