TAX DEVELOPMENT JOURNAL

VOLUME 6 FALL 2016 1-9

NEW HEIGHTENED REPORTING REQUIREMENTS FOR FOREIGN FINANCIAL ACTIVITIES: WHAT EVERY FIDUCIARY SHOULD KNOW ABOUT A DECEDENT'S UNFULFILLED COMPLIANCE OBLIGATIONS

*Fabio Ambrosio**

The content of this paper is the opinion of the writer and does not necessarily represent the position of the Internal Revenue Service.

Given that reporting requirements for foreign transactions are at the highest level in history and the government's own figures estimate that 98.7 percent of tax revenue lost to offshore sheltering is not recouped through Offshore Voluntary Disclosure Initiative (OVDI) programs, it can be deduced that the vast majority of cross-border transactions remain undisclosed. This paper explores whether, upon the death of a taxpayer, his/her unfulfilled obligation to file certain information returns with respect to foreign financial activities survives him/her. To the extent that another taxpayer, as fiduciary, inherits the decedent's burden to file delinquent information returns, this paper outlines the ambiguity regarding the statutory authority of the Internal Revenue Service (IRS) to collect the liability for related civil penalties personally against the fiduciary. While the IRS believes it has the authority to do so, this paper suggests otherwise.

Through a factual scenario focused on Section 6048 of the Internal Revenue Code, this paper concludes that a taxpayer's obligation to file information returns with respect to certain foreign financial activities survives him/her. The estate inherits this filing obligation as well as the

*Fabio Ambrosio, JD, LLM, MBA, CPA, CVA, MAFF, CFE, CGMA, is an assistant professor of accounting at Pacific Lutheran University in Tacoma, Washington, and a recurring visiting professor of accounting at Franklin University Switzerland and Guilin University of Aerospace Technology (China). Fabio is also an Appeals Officer, Estate & Gift Tax, at the Internal Revenue Service. E-mail: ambrosfa@plu.edu.

liability for civil penalties due to the late filing. However, to the extent that the estate's assets are prematurely distributed, there remains a genuine doubt about the IRS's ability to use Section 6901 of the Internal Revenue Code in order to collect against a fiduciary, even in cases where the executor had notice of the claim before making a distribution.

It is important to understand that this paper specifically discusses the authority of the IRS under Title 26 to collect certain penalties against fiduciaries. This paper does not suggest that the U.S. Government at large, through another agency or pursuant to the authority of another title of the US Code, would not have the authority to so collect.

INTRODUCTION

Gathering and sharing information has always been at the heart of every government agency's enforcement challenge. Domestically, the U.S. federal tax system has long relied on "information returns"[1] as a tool to verify tax compliance. While traditional tax returns are used to determine whether and how much tax the filer owes, information returns do not carry a tax settlement aspect and generally provide financial details concerning a taxpayer other than the filer. The distinction between traditional tax returns and information returns is crucial to this paper. Unlike traditional tax returns, an information return is not accompanied by a payment or refund when it is filed. Yet, the failure to file certain information returns may trigger penalties that are much harsher than those applicable to a failure to file a traditional tax return.

The economic globalization and unprecedented volume of cross-border transactions are exacerbating the need for tax authorities to exchange information, as activities can often escape the vigilant eyes of a compliance body. According to a 2008 U.S. Senate report, the use of secret offshore accounts to evade U.S. taxes costs the Treasury at least $100 billion annually.[2] In an effort to promote global fiscal transparency and compliance, the Organisation for Economic Co-operation and Development (OECD) has long been pushing for enhanced exchange of tax information.[3] In the United States, the importance of international

---

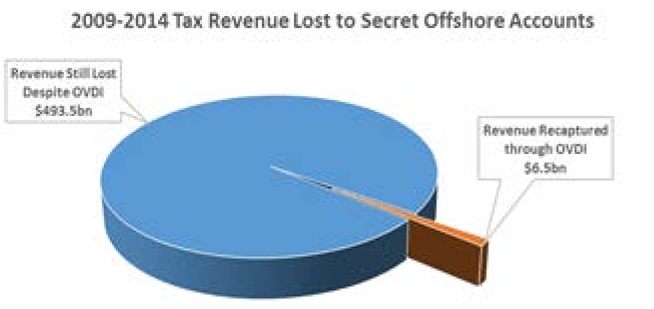
[1] Information returns are returns required to be filed pursuant to Chapter 61 of the Internal Revenue Code of 1986, as amended.

[2] Staff of S. Comm. on Homeland Sec. & Gov. Affairs, Perm. Subcomm. on Investigations, 110th Cong., 2d. Sess., *Report on Tax Haven Banks And U.S. Tax Compliance* 1 (2008), available at http:/hsgac.senate.gov/public/_files/-071708PSIReport.pdf [hereinafter 2008 SENATE REPORT].

[3] *See, e.g.*, OECD and Council of Europe, *The Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol*, OECD Publishing (2011), available at www.oecd-ilibrary.org/taxation/the-multilateral-convention-on-mutual-administrative-assistance-in-tax-matters_9789264115606-en; *see also* OECD, *Standard for Automatic Exchange of Financial Information in Tax Matters: Implementation Handbook* (2016), available at http://www.oecd.org/ctp/exchange-of-tax-information/implementation-handbook-standard-for-automatic-exchange-of-financial-information-in-tax-matters.pdf.

exchanges of information with respect to cross-border transactions became particularly evident when the Swiss bank UBS entered into a deferred prosecution agreement for having offered U.S. taxpayers offshore financial vehicles to hide assets and evade U.S. taxes.[4]

In response to the UBS scandal, the Foreign Account Tax Compliance Act of 2010[5] heightened the reporting burden of certain U.S. taxpayers with a financial interest in one or more foreign accounts.[6] In addition the IRS implemented its first short-term OVDI in 2009, followed by a second short-term OVDI in 2011, and a third OVDI in 2012, which is still open and accepting applications. In June 2014, the IRS announced that "[s]topping offshore tax cheating and bringing individuals back into the tax system has been a top priority of the Internal Revenue Service for several years" and that "the three voluntary programs have resulted in more than 45,000 voluntary disclosures from individuals who have paid about $6.5 billion in back taxes, interest and penalties."[7] Compared to the 2008 Senate report estimate that $100 billion in tax revenue is annually lost to offshore tax avoidance,[8] the voluntary disclosure programs have recaptured only 1.3 percent[9] of lost revenue over the five-year period from 2009 to 2014.[10]



Failure to file information returns disclosing foreign assets or financial activities may trigger steep civil penalties[11] under the Internal Revenue Code (the Code) and the Bank Secrecy Act.[12] The juxtaposition of a taxpayer's unfulfilled reporting obligations with his/her death is at the

[4] United States v. UBS AG, No. 09-cr-60033, ECF No. 4 (S.D. Fla. 2009).
[5] Enacted as part of The Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, §§ 501-541, 124 Stat. 71 (Mar. 18, 2010).
[6] *See* I.R.C. §§ 679, 1471, 1472, 6038D, 6048.
[7] IRS Fact Sheet 2014-6 (June 2014), available at https://www.irs.gov/uac/newsroom/irs-offshore-voluntary-disclosure-efforts-produce-6-5-billion-45-000-taxpayers-participate.
[8] *See* 2008 SENATE REPORT, *supra* note 2.
[9] This amount is computed by dividing the total of $6.5 billion collected in the OVDIs by the $500 billion estimated lost tax revenue over five years.
[10] This estimate is very conservative in that it does not account for the fact that the $6.5 billion figure provided by the IRS includes interest, which is not recovered tax revenue but simply the cost of money over time
[11] For example, in the context of FBAR violations, the maximum civil penalty for a willful failure to disclose is the greater of $100,000 or 50 percent of the balance of the undisclosed account each year. 31 U.S.C. § 5321(a)(5)(C). Before an amendment that took effect in 2004, the same section authorized penalties equal to 100 percent of the balance of the undisclosed account each year (still not to exceed $100,000). *See, e.g.*, Williams v. Comm'r, 131 T.C. 54 (2008); United States v. McBride, 908 F. Supp. 2d 1186, 1209 (D. Utah 2012).
[12] Pub. L. No. 91-508, 84 Stat. 1114-2 (Oct. 26, 1970).

heart of this paper. To the extent that a fiduciary may inherit the decedent's burden to file delinquent information returns, this paper explores whether and how the government may collect the liability for related civil penalties personally against the fiduciary.

LIABILITY OF THE ESTATE

When the first OVDI program was offered in 2009, executors could not properly evaluate the benefits of the program to an estate. It was unclear whether a deceased taxpayer's obligation to file information returns with respect to foreign financial activities survived him/her and if related civil penalties for failure to do so could be assessed against his/her estate. In other words, the pivotal question was whether *the estate* would be (a) responsible for filing delinquent information returns and (b) liable for related penalties.

In a Chief Counsel Advice issued in February 2012 (the February 2012 CCA), the IRS opined that, although the decedent was the person required to file the applicable information returns, the estate stepped into the shoes of the decedent and assumed the liability for civil penalties accrued due to the decedent's failure to comply during his lifetime.[13] This view is consistent with Section 6903,[14] which provides that the executor assumes the "rights, duties, and privileges" of the decedent, including paying any outstanding liabilities of the decedent.[15]

The February 2012 CCA only addresses whether *the estate* inherits the decedent's unfulfilled filing obligations and liability for resulting civil penalties. It does not discuss the implications of Chapter 71[16] concerning fiduciaries in cases where *the executor* (a) fails to file the decedent's delinquent information returns and/or (b) causes the estate's assets to be dissipated before the failure to file penalties under Chapter 68 are paid. If the government is no longer able to collect penalties against *the estate*, what challenges would it face in attempting to collect personally against *the executor* as a fiduciary?

PERSONAL LIABILITY OF A FIDUCIARY

The interplay of Chapter 71 and Chapter 68 is best outlined through a hypothetical fact scenario. Suppose that Ms. Forgetful, a U.S.

---

[13] Chief Couns. Adv. 201208028 (Feb. 24, 2012).

[14] All references to "Sections" are to sections of the Internal Revenue Code, as amended, except for references to "Section 3713," which are to Section 3713 of Title 31, Money and Finance of the U.S. Code.

[15] I.R.C. § 6903(a); see also Marianne R. Kayan & Ashley A. Weyenberg, *Foreign Trusts: Form 3520 and Form 3520-A Filing Deadlines and Liability of a Decedent's Estate*, 27 PROB. & PROP. 56 (July/Aug. 2013).

[16] All references to "Chapters" are to chapters of the Internal Revenue Code of 1986, as amended..

citizen and resident, formed a foreign trust[17] on January 1, 1990, and funded it with $1 million cash. From 1990 until 2013 Ms. Forgetful made several cash transfers to and from the foreign trust. Ms. Forgetful died on January 1, 2015, without ever having filed a single information return with respect to any of the transactions involving the foreign trust. Suppose further that Mr. Next was appointed executor of the estate and caused the estate to file all delinquent information returns within nine months of Ms. Forgetful's death, to which the IRS responded by assessing civil penalties against the estate under Section 6677 for the decedent's failure to timely file the requisite information returns. Suppose, at last, that the estate held plenty of assets to satisfy all claims against it. Despite having knowledge of the government's claim stemming from the Section 6677 civil penalties, Mr. Next only discharged obligations to creditors other than the United States, thereafter distributing the residual estate assets to the beneficiaries**.**

Since the purpose of this paper is to focus on the executor's potential exposure to personal liability, it is assumed that the above hypothetical scenario satisfies all requirements necessary to trigger an obligation to file information returns by the decedent and related liability for civil penalties against his/her estate. Therefore, it is assumed that (1) the creation of the foreign trust in 1990 was a "reportable event";[18] (2) each transfer of assets to and from the foreign trust from 1990 until 2013 was a separate "reportable event";[19] (3) the reportable events generated an obligation to file information returns on Form 3520;[20] (4) the required Forms 3520 were not filed within the prescribed period;[21] (5) resulting civil penalties under Section 6677 would be assessable against the decedent, if living;[22] (6) upon the taxpayer's death the executor became a "responsible party"[23] with respect to all unfiled information returns; (7) upon becoming a responsible party, the executor became a "person required to file"[24] all delinquent Forms 3520; and (8) upon becoming a person required to file, the executor became a "person required to pay"[25] the penalties. Thus, the ultimate issue is whether and how the government may proceed to collect the penalties personally against the executor pursuant to Chapter 71.

The only piece of administrative guidance seemingly on point is a laconic Chief Counsel Advice issued in March 2012 (the March 2012 CCA).[26] The issue allegedly addressed in the March 2012 CCA is whether the executor is personally liable for the estate's *liabilities* if the estate's

[17] Within the meaning of Treas. Reg. § 301.7701-7(a)(2).
[18] Within the meaning of I.R.C. § 6048(a)(3)(A)(i).
[19] Within the meaning of I.R.C. § 6048(a)(3)(A)(ii).
[20] Treas. Reg. § 16.3-1(c).
[21] Treas. Reg. § 16.3-1(e).
[22] Treas. Reg. § 16.3-1(f)(2).
[23] Within the meaning of I.R.C. § 6048(a)(4)(C).
[24] Within the meaning of I.R.C. § 6677(a).
[25] *Id.*
[26] Chief Couns. Adv. 201212020 (Mar. 23, 2012).

assets have been prematurely distributed. The legal analysis in the March 2012 CCA correctly states that "a fiduciary of an estate without enough property to pay all claims of the estate must pay the *federal tax* claim before other claims," but only "if he had notice of the claim of the government before making a distribution to another creditor." [27] The March 2012 CCA concludes that the executor will "be personally liable for the *penalties* if … the executor paid off other creditors instead of paying the IRS."[28]

Section 3713[29] is a general federal statute that provides that debts due to the United States shall be satisfied first if the assets of the estate are insufficient to pay all debts.[30] The statute imposes personal liability on a fiduciary for estate debts due to the United States whenever the fiduciary settles third-party claims before satisfying claims of the United States.[31] The term "claims of the United States" within the meaning of Section 3713 includes all federal taxes, whether or not assessed.[32] However, a fiduciary is personally liable for federal taxes only if he/she discharges obligations to creditors other than the United States with knowledge of the tax liability owed to the United States.[33]

There is a wide gap between the issue, the legal analysis, and the conclusion presented in the March 2012 CCA. The March 2012 CCA mixes the terms liabilities, tax, and penalties indiscriminately, reasoning, without apparent support, that laws applicable to taxes are equally applicable to penalties and liabilities in general. The March 2012 CCA does not differentiate among liabilities; it does not define or categorize taxes; most importantly, it fails to recognize the difference in purpose, procedure, and enforcement of penalties. The gist of the March 2012 CCA is that the combination of Sections 3713 and 6901 is sufficient to collect all unpaid debts of a decedent from an executor so long as (a) the executor knew of the debt, (b) the estate's assets were sufficient to pay the debt, and (c) the executor made distributions to anyone other than the IRS. As outlined in the next portion of this paper, the March 2012 CCA grossly discounted a more complex technical issue.

---

[27] *Id.* (emphasis added).
[28] *Id.* (emphasis added).
[29] While this paper refers to 31 U.S.C. 3713 as "Section 3713" for literary convenience, it is important to remember that this statute is in a different title of the United States Code (Title 31) than all other statutes cited in this paper, which are in Title 26.
[30] 31 U.S.C. § 3713(a).
[31] 31 U.S.C. § 3713(b); in United States v. Estate of Kime, 950 F. Supp. 950 (D. Neb. 1996), the executor was found personally liable under 31 U.S.C. § 3713(b) for having fully distributed estate's assets before satisfying a tax liability owed to the federal government.
[32] Price v. United States, 269 U.S. 492 (1926).
[33] In re Gottheiner, 703 F.2d 1136, 1140 (9th Cir. 1983); Want v. Comm'r, 280 F.2d 777, 783 (2d Cir. 1960). In the hypothetical scenario discussed in this paper, Mr. Next clearly had knowledge of the government's claim when he discharged obligations owed to other creditors.

Section 6901 creates a framework for collection of fiduciaries' vicarious liabilities arising under Title 31. The Supreme Court in 1958 explained that Section 6901 does not impose liability but merely gives the Commissioner of the Internal Revenue a procedure or remedy to enforce the transferor's existing liability.[34] The plain language of Section 6901, however, does not mirror the plain language of Section 3713. Section 6901 in fact narrows a concept as large as a "claim of the United States government"[35] and limits it to liabilities arising from outstanding income, estate, and gift taxes.[36] From rules of statutory construction, it can be inferred that the express inclusion of income, estate, and gift taxes excludes everything else from the purview of Section 6901.[37] Therefore, the March 2012 CCA is correct insofar as the government could rely on Section 3713 to assert fiduciary liability for unpaid income, estate, and gift taxes,[38] and collect that liability against a fiduciary using Section 6901 as remedy. A more complex question not addressed in the March 2012 CCA is whether the government can also rely on Section 3713 to assert fiduciary liability for any other tax or penalty unrelated to income, estate, or gift taxes and still be able to collect that liability against a fiduciary using Section 6901 as remedy.

In *Lawrence v. United States*,[39] the only judicial authority on point, the plaintiff was the executrix and sole beneficiary of a relative's estate. Four years after the plaintiff had marshaled the estate, paid out all claims, and distributed the estate's assets, the IRS assessed certain penalties arising under Chapter 68 against the estate. As the estate was insolvent, the government moved to levy directly against the executrix pursuant to Section 6901. The executrix successfully moved for an injunction. In holding for the plaintiff, the court made two crucial determinations: (1) the IRS had not followed state law in presenting a claim against the estate within the time prescribed by the Texas Probate Code, and (2) "[t]he provisions of Section 6901 … do not apply to the 100% [p]enalty assessment for excise taxes under Section 6672."[40]

Why would the provisions of Section 6901 not apply to the penalty assessment under Section 6672? What is different about Section 6672?

Section 6672 is in Chapter 68 of the Code. Most Chapter 68 penalties do not require judicial review prior to assessment and are thus

[34] *See* Comm'r v. Stern, 357 U.S. 39, 42 (1958) (discussing statutory predecessor of Section 6901).
[35] As contained in 31 U.S.C. § 3713(a).
[36] I.R.C. § 6901(a)(1). Section 6901(a)(2) also includes a reference to "other taxes" but the term is limited to liquidations of partnerships or corporations, or type-A reorganizations under I.R.C. § 368(a), all of which are irrelevant to the hypothetical scenario.
[37] *Expressio unius est exclusio alterius*.
[38] *See, e.g.*, United States v. Cole, 733 F.2d 651 (9th Cir. 1984).
[39] Lawrence v. United States, 265 F.Supp. 590, 591 (N.D. Tex. 1967).
[40] *Id.* at 591.

commonly referred to as "post-assessment appeal" penalties.[41] Section 6211 reserves judicial review prior to assessment only for cases where additional income, estate, or gift taxes, and/or related penalties are proposed. Most Chapter 68 penalties are not computed on the basis of an underlying or related tax (whether income, estate, or gift). Therefore, in most cases concerning the assessment of Chapter 68 penalties, the IRS will not issue a notice of deficiency.[42] Without a notice of deficiency, the Tax Court will not have jurisdiction of the case.[43] Without Tax Court jurisdiction, the taxpayer does not have a pre-payment forum prior to assessment of the penalties.[44] In these cases, a taxpayer wishing to seek judicial review on the merits[45] must pay the penalty assessed and sue for refund in a federal district court or before the U.S. Court of Federal Claims.

In sum, unlike income, estate, or gift tax deficiencies and related penalties, Chapter 68 penalties are assessed administratively before any judicial recourse is available to the taxpayer.[46] Considering that the assessment of these penalties bypasses the Tax Court, it would seem unwise to also empower an administrative agency such as the IRS to collect these penalties against fiduciaries without a pre-payment forum of judicial review.

As previously mentioned, the Supreme Court explained that Section 6901 is merely a collection procedure to enforce the transferor's existing liability.[47] The burden of proof is on the Commissioner to show that the transferee is liable.[48] If Section 6901 did not exclude Chapter 68 penalties, the IRS would have plenary powers to make a penalty assessment against a transferor/decedent and proceed unchallenged to collect against a transferee/fiduciary without court intervention. The transferee/fiduciary would then have to sue for refund in order to obtain a first judicial review on the merits. This is most probably, in the opinion of the author, why the *Lawrence* court held that "[t]he provisions of Section 6901 … do not apply to the 100% [p]enalty assessment for excise taxes under Section 6672."

---

[41] IRM 20.1.1.4 (Feb. 22, 2008).
[42] I.R.C. § 6212.
[43] I.R.C. § 6213.
[44] This discussion focuses on the taxpayer's recourse prior to assessment and disregards the notice and opportunity for hearing before levy that the taxpayer would still have under I.R.C. § 6330.
[45] Other than a hearing before levy under 26 U.S.C. § 6330.
[46] A suit for refund would be predicated on prior assessment and payment.
[47] *See* Comm'r v. Stern, *supra* note 34 (discussing statutory predecessor of Section 6901).
[48] I.R.C. § 6902.

CONCLUSION

Chapter 68 penalties arise from a failure to file information returns. Information returns do not carry a tax settlement aspect and generally serve as mere disclosures. For this reason, Chapter 68 penalties escape deficiency procedures and can be assessed without a pre-payment form of judicial review. The mechanics of Section 6901 align with this distinction in that they treat differently the collection of tax vis-à-vis the collection of non-tax charges.

Returning to the hypothetical scenario, the government would want to argue that the executor is personally liable as fiduciary because the Chapter 68 penalties constitute a "claim of the United States Government" within the meaning of Section 3713. The executor, on the other hand, would want to argue that the more specific statute, Section 6901, is controlling[49] and limits the government's right to assert personal liability against the executor solely to claims deriving from the decedent's unpaid income, estate, or gift taxes, none of which apply to Chapter 68 penalties. Paradoxically, the end result might be that, while Section 3713 holds the executor personally liable for the penalties, Section 6901 does not permit the IRS to collect against him/her.[50]

In light of the conflicting authority on point, a prospective executor should proceed with caution before accepting a fiduciary role with respect to the estate of a decedent bearing a financial interest in one or more foreign accounts.

[49] See Brown v. GSA, 425 U.S. 820 (1976) (a precisely drawn, detailed statute preempts more general remedies).
[50] The fiduciary liability procedures of I.R.C. § 6901 and 31 U.S.C. § 3713 constitute only two methods the IRS may employ to collect taxes from persons or entities other than the taxpayer who initially incurred the liability. Another method the IRS has used in the past includes the theory of fraudulent transfers, whether brought under state law or pursuant to the Federal Debt Collection Procedures Act of 1990, 28 U.S.C. § 3001 *et seq.* In such cases, the IRS may be able to set aside fraudulent conveyances and recover the amount owed. *See, e.g.*, United States v. Craft, 535 U.S. 274 (2002); United States v. Lombardi, 924 F. Supp. 361 (R.I. 1996). The applicability of alternative theories is outside the scope of this paper.