

Penalties On Unreported Foreign Trusts Must Be Paid In Full To Obtain District Court Or Claims Court Jurisdiction

Sunday, December 25, 2011

Taxpayers that desire to contest an IRS assertion of tax liability in Federal district court or the Court of Federal Claims must first FULLY pay the asserted tax liability, and then sue for a refund. If the liability is high enough, a taxpayer may be unable to afford to do this.

However, under the “divisible tax” analysis, some tax penalties may be divisible from others – when that analysis applies, the taxpayer can only pay some and not all of them, and still get to court by suing for a refund. In a recent Chief Counsel Advice, the issue was raised whether Code §6048 penalties failures to report contributions to, ownership of, and distributions from foreign trusts are “divisible taxes” that would allow for less than all asserted penalties to be paid and still allow a refund suit.

At first, such penalties would appear to be divisible, since different penalties arise under Code §6048 for different types of failures to report, and because multiple tax years may be involved. Nonetheless, the IRS concluded that Code §6048 penalties are NOT divisible. Thus, taxpayers seeking to get to district court or the Claims Court will need to first prepay all asserted penalties in full.

The theory of the CCA was that if payment of only one portion of the penalty was sufficient for jurisdiction, the court nonetheless would have full jurisdiction of all the asserted penalties. Further, different reasonable cause defenses against different portions of the penalty could be argued by the taxpayer. The CCA concluded that this was inconsistent with the theory of a “divisible tax,” and thus partial payment would not give rise the sought after jurisdiction.

There are two important provisos to this determination. First, this is only the IRS’ position, and thus a taxpayer could contest that determination in court. Second, the CCA notes that if the taxpayer is willing to drop its opposition to the unpaid tax portion, it

could proceed to obtain court jurisdiction over a *portion* of the penalties asserted by paying just those penalties first.

Chief Counsel Advice 201150029

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