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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

JINMING ZHANG, Plaintiff, v. **INTERNAL REVENUE SERVICE;** **UNITED STATES OF AMERICA,** Defendants.	Case No. 4:24-cv-08210-AMO **PLAINTIFF'S REPLY TO UNITED STATES' OPPOSITION TO PLAINTIFF'S CROSS-MOTION FOR SUMMARY JUDGMENT** **Judge:** Hon. Araceli Martinez-Olguin **Date:** November 5, 2026 **Time:** 2:00 pm PST **Place:** Oakland, Courtroom 5, 2nd Floor

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INTRODUCTION

The U.S. tax system is based upon voluntary compliance. The Internal Revenue Code "IRC" incentivizes taxpayers to comply by applying penalties for noncompliance. However, penalties should only apply to negligent, reckless, or intentional conduct. Taxpayers should not be penalized when they discover errors or mistakes and voluntarily come forward and file late information returns. [1] About a decade ago, the IRS shifted its policy on international reporting penalties and began automatically assessing penalties when taxpayers voluntarily filed late returns. *See* Erin M. Collins, *IRS Hears Concerns from TAS and Practitioners, Makes Favorable Changes to Foreign Gifts and Inheritance Filing Penalties*, Nat'l Taxpayer Advoc. Blog (Oct. 24, 2024), https://www.taxpayeradvocate.irs.gov/news/nta-blog/irs-hears-concerns-from-tas-and-practitioners-makes-favorable-changes-to-foreign-gifts-and-inheritance-filing-penalties/2024/10/. No questions asked - just the imposition of potentially life-altering penalties. Ms. Zhang received $287,108 of wedding gifts from her parents, grandparents, and uncles in China. Deposition of Jinming Zhang ("Zhang Depo.") 60:5 to 62:17; Zhang Depo. Ex. 2 at 6–7. Because foreign and domestic gifts are generally not taxable, Ms. Zhang did not believe her wedding gifts had to be disclosed on any U.S. tax returns, including a Form 3520. Zhang Depo. 50:11-13.

[1] *See, e.g.,* NAT'L TAXPAYER ADVOC., April 23, 2025, IRS HEARS CONCERNS FROM TAS AND PRACTITIONERS, MAKES FAVORABLE CHANGES TO FOREIGN GIFTS AND INHERITANCE FILING PENALTIES.

In 2018, Ms. Zhang prepared her and her husband's 2017 federal income tax return. Zhang Depo. 38:17 to 39:22. She relied on TurboTax, one of, if not the most, widely used tax-preparation software in the U.S. to prepare her 2017 income tax return. *See* Zhang Depo. 40:7 to 41:9; Intuit Inc., *Intuit Reports 6 Percent Increase in TurboTax Online Units*, SEC Edgar Ex. 99.01 (Apr. 25, 2018). When preparing her 2017 individual income tax return, Ms. Zhang had access to both the TurboTax software guidance and the official 2017 IRS individual income tax instructions. Neither properly warned her of her need to file Form 3520 to report her wedding gifts. Ms. Zhang discovered her Form 3520 filing requirement in October of 2018. Zhang Depo. 57:6-9. At that point Ms. Zhang immediately came forward to the IRS to correct the mistake by filing a Form 3520 with the IRS late. Zhang Depo. 57:6-21. The IRS rewarded her voluntary compliance by assessing her a $71,777 Section 6039F penalty. Zhang Depo. 74:20-25. The only reason the IRS was able to assess a Section 6039F penalty against Ms. Zhang is because she voluntarily filed the Form 3520. The IRS's position to assess severe penalties against a taxpayer that not only acted reasonably but also did the "right thing" by correcting her error will likely be perceived as extraordinarily unfair by many taxpayers. An overly severe penalty, such as the Section 6039F penalty assessed against Ms. Zhang, may have a chilling effect on voluntary disclosures and make it difficult to preserve marginal deterrence in tax compliance cases (*i.e.*, the notion that greater

transgressions should trigger larger penalties). [2] Trust in the government, the tax laws, and the IRS is correlated with voluntary compliance, and the imposition of perceived unfair penalties is correlated with noncompliance. [3] The IRS's heavy handed approach in this case may result in serious collateral damage which ultimately reduces taxpayer compliance and decreases incentives for taxpayers to correct previous filing errors. [4]

ARGUMENT

1. The IRS Incorrectly Classifies a Section 6039F Penalty as a Strict Liability Penalty

In its Opposition and Response Brief, the IRS erroneously states that Section 6039F is a "strict liability statute". Defendant's Opposition Brief pg. 2. The IRC does not contain a single section that broadly defines the term "strict liability" as a general legal principle. Instead, strict liability in federal tax law applies specifically through penalty provisions like IRC Section 6662(b)(6) and Section 6662(i) which impose

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[2] *See* George J. Stigler, The Optimum Enforcement of Laws, in Essays in the Economics of Crime and Punishment 55, 57 (Gary S. Becker & William M. Landes eds., 1974) ("If the offender will be executed for a minor assault and for a murder, there is no marginal deterrence to murder.").

[3] *See* Nat'l Taxpayer Advoc., 2012 Annual Report to Congress 1, 35 (2012) (finding that trust in government, tax laws, and the IRS is more significantly associated with voluntary compliance among small businesses than most other factors including economic deterrence).

[4] *See* e.g., Bruno S. Frey & Lan P. Feld, *Deterrence and Morale in Taxation: An Empirical Analysis* (CESifo Group, Working Paper No. 706, 2002) (suggesting that treating taxpayers with respect increases their tax moral, but relying solely on deterrence prompts taxpayers to engage in active tax avoidance).

no-fault penalties for transactions lacking economic substance. In 2010 Congress specifically enacted a strict liability penalty which applies to understatements resulting from certain transactions that lack "economic substance" (*i.e.*, that do not result in a meaningful change to the taxpayer's economic position other than a purported reduction in federal income tax). *See* Health Care and Education Reconciliation Act of 2010, 111 Pub. L. No. 152, Section 1409, 124 State. 1029, 1069 (codified at Section 7701(o)). Section 6662A specifically imposed a strict liability penalty for reportable transactions. Section 6039F contains no such language regarding strict liability. Section 6039F mandates a penalty "[s]hall not apply to any failure to report a foreign gift if the United States person shows that the failure is due to reasonable cause and not due to willful neglect." IRC Section 6039F(c)(2). "Reasonable cause" is nowhere defined in Section 6039F or its regulations. That phrase, however, appears repeatedly in statutes governing the IRS's tax assessment role. For example, Section 6664(c)(1) of the IRC prohibits penalties for any portion of an underpayment of tax "if it is shown that there was reasonable cause for such portion and the taxpayer acted in good faith with respect to such portion." Another statute, applicable to foreign trusts, prohibits penalties for "any failure which is shown to be due to reasonable cause and not due to willful neglect." IRC Section 6677(d). In IRC Section 6651(a)(1), Congress prohibits monthly penalties for failing to file tax returns where "such failure is due to reasonable cause and not due to willful neglect." There is no reason to think that Congress intended the meaning of

"reasonable cause" in Section 6039F to differ from the meaning ascribed to it in tax statutes or that Congress intended the Section 6039F to be a strict liability statute. If Congress intended enforcement of the Section 6039F provisions to be interpreted differently or as a strict liability statute such as the no-fault provisions reserved for transactions that lack economic substance, it left no clues in the statute.

2. The IRS's Own Instructions Indicated that Ms. Zhang did Not Have a 3520 Filing Requirement

Ms. Zhang stated in her deposition that she did not know she had to disclose her wedding gifts on Form 3520. Zhang Depo. 64:11-14. This is not surprising. Most U.S. taxpayers are unaware they have any special reporting requirements associated with certain foreign gifts. The IRS has even acknowledged that most taxpayers are oblivious of the need to file Form 3520 when they receive a foreign gift, particularly because such an event does not trigger a taxable event for U.S. purposes. As a matter of fact, the IRS stated the following in a recent training guide.

"In general, gifts and inheritances are not taxable to the recipient. Many taxpayers and representatives know the basic tenant of tax law but are not aware of the requirement to report large foreign gifts and inheritances under [Section] 6039F."
IRS Voluntary Disclosure Practice Examiner Guide, 2022 Tax Notes Today Federal 138-24 (July 9, 2022), at 44; *See also* I.R.S. Chief Counsel. INFO 2013-0015 (March 29, 2013).

Even though the IRS is fully aware that most taxpayers are oblivious to their Form 3520 filing requirements, the IRS does not raise the potential need to submit Form

3520 upon the receipt of a foreign gift on its tax Form 1040 and instructions to the Form 1040. *See* I.R.S. Form 1040, Schedule B, Part III (2017); I.R.S., Instructions for Schedule B (Form 1040), at B-2 (2017), https://www.irs.gov/pub/irs-prior/i1040sb--2017.pdf.

Not only does Schedule B and the Schedule B instructions make no mention of possible Form 3520 duties in situations where U.S. individuals receive foreign gifts, the Schedule B and the Schedule B instructions only discuss the need to file a Form 3520 if a taxpayer receives a distribution from a foreign trust, was the grantor of a foreign trust, or was a transferor to a foreign trust. *See* Id. Schedule B and the instructions to Schedule B for the Form 1040 imply that only individuals that had dealings with foreign trusts need to file a Form 3520 with the IRS. Ms. Zhang did not receive a distribution from, was a grantor of, or made a transfer to a foreign trust in 2017. Ms. Zhang did not blindly rely on TurboTax to prepare her 2017 tax return. Ms. Zhang reviewed the draft tax return prepared by TurboTax. Zhang Depo. 64:15-24. Ms. Zhang also carefully read Schedule B and its instructions. Zhang Depo. 66:12 to 68:25. Ms. Zhang followed these instructions and properly disclosed her foreign financial accounts on Schedule B and on an FBAR. Zhang Depo. 68:2-25. These same instructions indicated that the filing of a Form 3520 was limited to dealings with foreign trusts. A reasonable person, particularly a first year tax resident, reading the IRS's instructions would believe that the need to file a Form 3520 is limited to dealings with foreign

trusts. Ms. Zhang relied on Schedule B and the instructions to Schedule B to determine she had no further filing obligations with the IRS.

As a general rule, taxpayers cannot rely on form instructions for filing positions. For example, in *Adler v. Commissioner,* 330 F.2d 91 (1964), the Ninth Circuit Court of Appeals rejected a taxpayer's attempt to claim he was "misled" by language in an IRS pamphlet into thinking that his dancing lessons were deductible. Similarly, in *Green v. Commissioner*, 59 T.C. 456, 458 (1972), the taxpayer claimed that language in an IRS publication entitled him to deduct commuting expenses. Even accepting the taxpayer's reading of the publication, the court observed that IRS publications cannot override authoritative sources of law like tax statutes and regulations. With that said, the IRS does make mistakes and misstatements, and in the right circumstances, there should be consequences. Regardless of whether the IRS' conduct was intentional, innocent, or somewhere in between, a taxpayer is sometimes correct in relying on an IRS publication. A key case supporting the taxpayer's right to rely on form instructions is *Wilkes v. United States,* 50 F. Supp.2d 1281(M.D. Fla. 1999). In *Wilkes*, the IRS sought to hold an estate's executor liable for unpaid estate tax. The executor had previously sold the estate's stock shares and believed that doing so had discharged him from liability. The court noted that the IRS's position was inconsistent with the statute, the legislative history, and the form instructions, all of which would relieve the executor of liability. The court clearly acknowledged that the form instructions were not dispositive.

Nonetheless, the court appropriately stated that "general principles of equity dictate that the IRS should not be allowed to issue instructions for completing its forms and later disavow those instructions." *See* Id.

During the tax year at issue before this Court, the IRS was fully aware that most taxpayers were unaware of Form 3520 during situations involving foreign gifts. Yet the IRS's own instructions strongly imply that the need to file a Form 3520 is limited to taxpayers that have dealings with foreign trusts. Ms. Zhang relied on the IRS instructions to determine she did not have any further international filing obligations other than an FBAR and she did not need to file a Form 3520. The IRS does not have clean hands in case. Knowing that the vast majority of taxpayers are not aware of their obligation to disclose foreign gifts on a Form 3520, the IRS cannot in good faith issue confusing instructions and then demand taxpayers conduct in-depth Google searches on an obscure form that its own instructions state does not apply to them. Beyond the reasoning in *Wilkes*, other authority supports holding the IRS to its publications in this instance. For example, in *Paige v. Harris,* 584 F.2d 178 (7th Cir. 1978), the Seventh Circuit indicated that some internal rules of the Department of Housing and Urban Development established personnel policies and procedures might be binding to HUD. In a later case, the Seventh Circuit cited *Paige* and noted that in proper circumstances, a federal agency can be bound by its own regulations even though those regulations merely establish internal operating procedures. *See Bartholomew v. United States,* 740

F.2d 526, 530-531 (7th Cir. 1984). When an agency issues instructions to the public, as is the case with IRS form instructions, the argument seems even stronger for holding the government to its words. Since the IRS's own instructions limit the filing of a Form 3520 to dealings with foreign trusts as in this case, the IRS should be bound by those instructions.

3. Case Law Holds Reasonable Cause Must be Determined on a Case-By-Case Basis

The IRS mischaracterizes Ms. Zhang's reasonable cause position as being nothing more than ignorance of law alone. Federal cases support a reasonable cause defense to international penalties based on ignorance of law coupled with other factors such as the lack of advice. Ms. Zhang's reasonable cause defense is based on ignorance of law and coupled with other factors. A number of federal district court decisions define when ignorance of law coupled with other factors establish reasonable cause for the late filing of an international return such as a Form 3520. In *Kelly v. Commissioner,* T.C. Memo. 2021-76 (2021), *aff'd on other issue*, 139 F.4th 854 (9th Cir. June 5, 2025), the court held reasonable cause was a defense to a penalty associated with Form 5471 when a preparer was provided with all necessary information. In *Nance v. United States,* 2013 WL 1500987 (W.D. Tenn. 2013), the court denied the IRS's summary judgment motion on reasonable cause as to Form 3520-A. The court noted the lack of advice and actual knowledge on the part of the taxpayer. *In re Wyly,* 552 B.R. 338 (U.S. Bankr. Ct.

N.D. Tex. 2016), the court acknowledged that an advisor's failure to mention that an international information return must be filed can constitute advice. In *Congdon v. United States,* 4:09-CV-289 2011 WL 3880524 (E.D. Tex. Aug, 2011), the court denied an IRS summary judgment motion on reasonable cause as to Form 5471, noting ignorance of the taxpayer, inexperience of the taxpayer, complexity, no tax loss, and information disclosed elsewhere on the tax return. For purposes of reasonable cause, the core framework in the above discussed cases revolve around the inexperience of the taxpayer, lack of actual knowledge of the taxpayer, and the failure of a tax advisor to mention the need to file the information return. All of the core framework for purposes of a reasonable cause defense to an international penalty discussed in the above cases is present in Ms. Zhang's case: 1) Ms. Zhang was inexperienced in tax. Zhang Depo. 24:18 to 30:1; 2) The 2017 tax year was the first year Ms. Zhang filed tax returns with the IRS. Zhang Depo. 38:20-21; 3) Like the majority of U.S. citizens and residents, Ms. Zhang did not know that she had a Form 3520 filing requirement in 2017. Zhang Depo. 64:7-14; 4) Ms. Zhang provided all of her pertinent facts and information to her tax professional, TurboTax, and treated TurboTax as a professional providing advice; 4) Ms. Zhang did not bury her head in the sand and ignore her obligation to check the accuracy of her tax return and made her best effort to assess her tax liability. Zhang Depo. 64:15-24; and 5) Ms. Zhang read the IRS's instructions regarding the preparation of her tax return and reporting of her foreign financial assets. Zhang Depo. 66:12 to

68:25.

The IRS attempts to distinguish the *Congdon* decision from Ms. Zhang's case in that an incorrect international information return, a Form 5471 was filed in that case. A Form 5471 is typically filed by U.S. shareholders of a "controlled foreign corporation." The filing of a Form 5471 is necessary to comply with the Subpart F provisions of the IRC. The Subpart F provisions of the IRC have become clear over its near- 75 years of presence in the IRC. [5] There are significant differences between the facts in *Congdon* and Ms. Zhang's case. In *Congdon*, the taxpayer had to file a Form 5471 with the IRS to determine his taxable income. In Ms. Zhang's case, her foreign gifts were not subject to U.S. tax. Because foreign gifts are not taxable, it is easy for a taxpayer to assume he or she does not have an information return requirement. More importantly, U.S. shareholders of foreign corporations, such as the taxpayer in the *Congdon* case are typically sophisticated taxpayers conducting business abroad. On the other hand, recipients of foreign gifts that have a Form 3520 filing requirement are typically not sophisticated taxpayers. They are immigrants and newcomers to the U.S. Immigrants and newcomers to the U.S. are also disproportionately impacted by Section 6039F penalties. [6] Unlike the taxpayer in *Congdon*, Ms. Zhang did not have a foreign business

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[5] In 1962, Congress enacted the Subpart F provisions of the IRC. *See* John F. Kennedy 1961 Tax Message to Congress, at 107 Cong.Rec. 6458 (1961).

[6] *See, e.g,* NAT'L TAXPAYER ADVOC., February 9, 2024 INTERNATIONAL INFORMATION RETURN PENALTIES IMPACT A BROAD RANGE OF TAXPAYERS.

or foreign source income that needed to be disclosed on an information return. She was a newcomer to the United States that received wedding gifts that were not taxable on her returns. However, like the taxpayer in *Congdon*, Ms. Zhang was inexperienced in filing foreign information returns and there was no tax loss to the Government.

The IRS attempts to establish a so-called "meaningful step" standard or test through its interpretation of *United States v. Ott*, No. 18-cv-1274, 2019 WL 3714491 (E.D. Mich. Aug. 7, 2019). The IRS believes an FBAR case is analogous to a 3520 filing case. A defense to an FBAR penalty cannot be compared to a defense of a Section 6039F penalty. The IRS provides detailed instructions on Schedule B and the instructions to Schedule B as to how to comply with the FBAR reporting requirements. All a taxpayer needs to do is to read the instructions to Schedule B to discover they had an FBAR filing requirement and how to comply with the FBAR filing requirements. On the other hand, the IRS provides no instruction on the Form 1040 or its instructions alerting taxpayers of Form 3520 duties in situations where taxpayers receive foreign gifts. The *Ott* case and the IRS's proposed "meaningful step" test has no application to the present case.

4. The *Boyle* Standard Should No Longer Apply in the Age of Electronic Filing

The IRS heavily relies on *United States v. Boyle*, 469 U.S. 241, 245 (1985) in its briefs. The IRS claims that Ms. Zhang's only reasonable defense is if she received a "written opinion" by an accountant that she need not report her foreign gifts. *See*

Defendant's Opposition Brief pg 8. At the same time, the IRS encourages taxpayers to electronically file tax returns and boasts that 122 million taxpayers currently e-file tax returns. [7] The IRS's contradictory position raises a broader question: if the IRS encourages the use of software to prepare returns and penalizes taxpayers for following its advice, is the *Boyle* case still good law in the context of Section 6039F penalties. *Boyle* was decided many decades ago in 1985, well before the age of electronic filing. This raises the question as to whether *Boyle* is even relevant in the age of electronic filing. A frontal challenge to the relevancy of *Boyle* in the context of a late filing penalty nearly occurred in *Haynes v. United States*, 760 F. App'x 324 (5th Cir. 2019). In *Haynes*, the Fifth Circuit Court of Appeals indicated that in the age of electronic filing it was possible that the *Boyle* standard was no longer applicable and that it was possible a taxpayer could show reasonable care should a return fail to be filed to be electronically timely if the agent acted reasonably. But the court's opinion stopped short of finding that was the case and sent it back to the district court. There was no agent in Ms. Zhang's case as there was in *Haynes*. However, as the taxpayer in *Haynes*, Ms. Zhang electronically filed her return and she acted with reasonable cause.

In the 1985 *Boyle* case, a defense to a penalty only applies in situations where a return preparer gives erroneous substantive tax advice to a taxpayer. Times have

[7] Internal Revenue Service, *Several Great Reasons to E-file Your Federal Tax Return*, Pub. 4531 (rev. Nov. 2013), https://www.irs.gov/pub/irs-utl/OC-Severalgreatreasonstoefileyourfederaltaxreturn.pdf.

changed dramatically since the *Boyle* case was decided. In more recent cases, the most important factor in determining whether a reasonable cause exception applies is the extent of the taxpayer's effort to properly assess his or her tax liability. *See* Treas. Reg. Section 1.6664-4(b)(1); *Congdon v. United States,* 4:09-CV-289 2011 WL 3880524 (E.D. Tex. Aug, 2011); *Van Scoten v. Commissioner*, 439 F.3d 1243, 1259 (10th Cir. 2006) and *Olsen v. Commissioner*, T.C. Summ.Op. (2011). Ms. Zhang's case is consistent with these aforementioned cases. The reason Ms. Zhang did not timely file a Form 3520 was driven largely by the "unique facts and circumstances" of her case. She made an honest effort to assess her tax and filing obligations. Because Ms. Zhang had never prepared a U.S. income tax return, she relied on TurboTax software. As conceded in the IRS, "TurboTax is one of, if not the most, widely used consumer return preparation software in the United States." United States Motion for Summary Judgment pg. 4. The TurboTax software gave no specific warnings or indications in its terms and conditions that it may not be able to prepare all required forms required by the IRC. Intuit Depo. 53:8-12. And unlike in *Olsen*, TurboTax offered no specific software to ensure it could handle a Form 3520. Intuit Depo. 52:5-14. Ms. Zhang reviewed the 2017 draft tax return. The IRS instructions to Schedule B instructed Ms. Zhang to file an FBAR information return with the IRS if she had a financial interest or signature authority over foreign financial accounts. Even though TurboTax software did not prepare an FBAR, she followed the IRS instructions for Schedule B. She timely

prepared and filed an FBAR with the IRS. The IRS instructions for Schedule B and the Form 1040 makes no mention of possible Form 3520 duties in cases of foreign gifts. Because TurboTax software and the IRS's instructions failed to warn Ms. Zhang about her obligation to file it, in October of 2018, Ms. Zhang discovered she had a Form 3520 obligation and immediately filed the Form 3520 with the IRS. Ms. Zhang not only took "meaningful steps" to correctly file her tax returns, Ms. Zhang had an honest misunderstanding of the fact she had a Form 3520 filing obligation that was reasonable in the light of her experience, knowledge, and education.

CONCLUSION

Ms. Zhang met her burden in establishing a reasonable cause defense to the Section 6039F penalty. For these and other reasons above, the Court should grant Ms. Zhang's cross-motion for summary judgment and should deny the IRS's motion for summary judgment.

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