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**INTERNATIONAL  
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*Dealing with IRS International Information  
Return Penalties and Avoiding Malpractice  
Claims that Could Ruin Both You and Your  
Firm*

**42<sup>nd</sup> Annual International Tax Conference**

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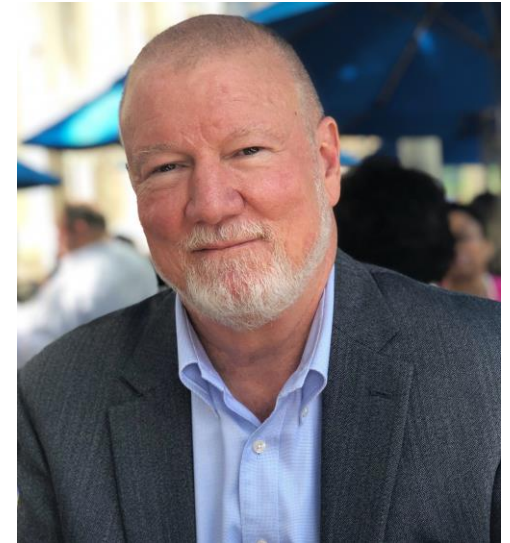
Larry specializes in international taxation, assisting clients ranging from small entrepreneurs to major multi-national subsidiaries with their individual and corporate work. He advises on a wide range of domestic and international tax issues with clients that include multinational corporations, partnerships, and entrepreneurs, as well as foreign persons investing in the United States. Having served international clients for more than 35 years, he has developed strong business ties in the international community. He is acknowledged as one of Florida's leading experts in international business and taxation and is fluent in Spanish and French

Chastang & Partners is a boutique international practice with multiple offices in Central and West Florida. The firm is focused on serving global high net worth families, entrepreneurs, multi-national corporations and private equity firms.

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Scott is a partner at a litigation boutique in Chicago and co-leads Sperling & Slater's tax shelter liability practice group which is focused on professional liability claims arising out of tax transactions.

Sperling's tax shelter liability group regularly works with tax professionals to protect clients' potential claims while IRS disputes are ongoing.

In August of this year, he obtained a \$65,500,000 Jury Verdict against a "Big 4" accounting firm related to its involvement in a Midco tax shelter transaction.

Prior to joining Sperling & Slater in 2006, Scott spent four years as a litigation associate at Kirkland & Ellis and was also a law clerk to the Hon. Karen LeCraft Henderson (D.C. Cir.). He graduated from the University of Chicago Law School with Honors and a B.A. from the University of Michigan.

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# Daniel N. Price

Dan's practice focuses on federal tax and Title 31 matters including civil and criminal defense of IRS audits and investigations and much more. Before founding his own firm, Law Offices of Daniel N. Price, PLLC, Dan served as an attorney for the Office of Chief Counsel of the IRS for more than 19 years. Dan's government service included extensive work in international tax enforcement. Dan's deep expertise concerning the IRS' voluntary disclosure practice, the Streamlined Filing Compliance Procedures, and international penalties allows him craft strategies to mitigate civil penalties and criminal exposure. Dan further assists taxpayers in battling significant penalties assessed by the IRS and certain state tax authorities.

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# Disclaimer

These slides are shorthand aids to an oral presentation. Neither these slides nor the oral presentation constitute legal or tax advice.



# Agenda

- US Reporting Overview
- IRS Enforcement and Penalty Administration
- Common Compliance Mistakes
- Malpractice Considerations
- Post-Assessment Penalty Strategies





Form	Code Section	Potential penalties*
<b>Form 926</b> (Return by a U.S. Transferor of Property to a Foreign Corporation)	6038B(c)	10% of the FMV of property transferred to foreign corporation (max. \$100,000)
<b>Form 3520-A</b> (Annual Information Return of Foreign Trust with a U.S. owner)	6677(b)	The greater of \$10,000 or 5% of the gross value of U.S. person's portion of foreign trust assets (measured as of the close of the U.S. person's tax year)
<b>Form 3520</b> (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts)	6677 6039F	Up to four penalties may apply. <ul style="list-style-type: none"> <li>For trust contributions, ownership, or distributions, a separate penalty applies for failure to timely report each transaction. Each penalty is equal to the greater of \$10,000 or (1) 35% of the trust contribution, (2) 5% of the gross value of U.S. person's portion trust assets (at close of U.S. person's tax year), or (3) 35% of the trust distribution</li> <li>For failure to timely report a foreign gift/bequest, a maximum penalty equal to 25% of the FMV of the foreign gift/bequest may apply</li> </ul>
<b>Form 5471</b> (Information Return of U.S. Persons with Respect to Certain Foreign Corporations)	6038	\$10,000 per form
<b>Form 5472</b> (Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in U.S. Trade or Business)	6038A	\$25,000 per form
<b>Form 5713</b> (International Boycott Report)	999	\$25,000, maximum 1 year imprisonment, or both for willful failure to report
<b>Form 8621</b> (Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund)	6501(c)(8)	Statute of limitations for tax year remains open until 3 years after form is filed

\* Additional/increased penalties may apply for intentional disregard of reporting requirements and/or continued noncompliance. The statute of limitations may also remain open indefinitely for failure to file the appropriate form (see Section 6501(c)(8))

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Form	Code Section	Potential penalties*
<b>Form 8854</b> (Initial Expatriation Statement)	877A, 6039G	\$10,000 per failure and potential treatment as “covered expatriate” subject to U.S. exit tax
<b>Form 8858</b> (Information Return of U.S. Persons with respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs))	6038(b)	Form 5471, Category 4/5 filers Form 8865, Category 1/2 filers \$10,000 per failure
<b>Form 8865</b> (Return of U.S. Persons with Respect to Certain Foreign Partnerships)	6038(b), 6038B(c), 6046A/6679	Multiple penalties may apply: <ul style="list-style-type: none"> <li>• \$10,000 per failure Category 1, 2, and 4</li> <li>• 10% of FMV of property transferred (capped at \$100,000) per Category 3 failure</li> </ul>
<b>Form 8938</b> (Statement of Specified Foreign Financial Assets)	6038D(d)	\$10,000 per form
<b>Form 8992</b> (U.S. Shareholder Calculation of Global Intangible Low-Taxed Income)	6038(b); Treas. Reg. 1.6038-5	\$10,000 per form
<b>FBAR</b>	31 USC 5321	<ul style="list-style-type: none"> <li>• Up to \$14,489 (after 1/24/2022) for “non-willful” violations</li> <li>• Up to the greater of \$144,886 (after 1/24/2022) or 50% of account balances, plus potential criminal penalties, for “willful” violations</li> </ul>
<b>Section 6662(j): Penalty of 40% of underpayment attributable to transaction involving undisclosed asset under Section 6038, 6038B, 6038D, 6046A, or 6048</b>		

\* Additional/increased penalties may apply for intentional disregard of reporting requirements and/or continued noncompliance. The statute of limitations may also remain open indefinitely for failure to file the appropriate form (see Section 6501(c)(8))



# Statute of Limitation Concerns

(8) Failure to notify Secretary of certain foreign transfers

(A) In general

In the case of any information which is required to be reported to the Secretary pursuant to an election under § 1295(b) or under § 1298(f), 6038, 6038A, 6038B, 6038D, 6046, 6046A, or 6048, the time for assessment of any tax imposed by this title 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 Secretary is furnished the information required to be reported under such section.

I.R.C. § 6501(c)(8)

# Statute of Limitation Concerns (cont'd)

Reasonable cause defense limits income to the foreign financial asset.

I.R.C. § 6501(c)(8)(B) Application to failures due to reasonable cause. If the failure to furnish the information referred to in subparagraph (A) is due to reasonable cause and not willful neglect, subparagraph (A) shall apply only to the item or items related to such failure.

- The IRS considers reasonable cause, discussed later, to be a very high standard

# IRS Enforcement and Penalty Administration

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# International Penalties Remain an IRS Priority

- IRS is committed to international information return enforcement and views penalties as revenue
- IRS is using data analytics to identify variances in reporting among information returns to open examinations
- Examiners actively identify international penalty issues

# International Penalties Remain an IRS Priority (cont'd)

- Treasury Inspector General For Tax Administration, Rep. No. 2023-30-019, The IRS Large Business and International Division Should Consider Shifting Individual Examination Resources to More Productive Examinations (May 25, 2023)
- LB&I WEIIC focuses on individual examinations involving international issues.
- Ninety percent of WEIIC individual examination closures reported less than \$200,000 total positive income (TPI) for Fiscal Years 2017 through 2021. pg. 7.
- “[T]he majority (73 percent) of WEIIC examinations conducted by its GS-13 revenue agents were of taxpayer returns reporting TPI less than \$200,000” for 2016 through 2020. pg. 11.
- “The IRS stated that the Dollars per Hour metric does not include the assessment of penalties, and that **penalties are a significant focus of [LB&I] WEIIC’s compliance effort.**” pg. 6.
- Takeaway point: LB&I WEIIC has spent the vast majority of its examination resources pursuing middle class taxpayers focusing on penalties.

# International Penalties Remain an IRS Priority (cont'd)

- Specific leads may spark examinations focusing on international penalty issues
  - Whistleblowers
  - [Foreign Account Tax Compliance Act](#) (a.k.a. FATCA)
  - Inter-governmental cooperation
  - Legacy use of [Swiss Bank Program](#) data and leads resulting from new non-prosecution agreements with DOJ Tax Division
  - [LB&I Campaigns](#)
  - John Doe Summonses

# IRS Penalty Administration Is Broken





# IRS Penalty Administration Is Broken

- Examinations often result in IRS agents asserting maximum penalties
- Not uncommon for total penalties asserted to exceed the underlying account balance
- “Innocent” mistakes are recast by IRS as willful errors
- Benign taxpayers who participated in legitimate transactions may be contacted by Criminal Investigation Special Agents

# IRS Penalty Administration Is Broken (cont'd)

- Systemic campus-based penalty assessments for international information returns brutalize taxpayers for doing the right thing
  - Form 3520 and Form 3520-A enforcement by Ogden Campus
    - Systemically applied penalties without considering reasonable cause
    - High rate of campus errors and high abatement rates
  - Form 5471 and Form 5472 for business filers
    - Systemically applied penalties without considering reasonable cause
    - High abatement rates

# IRS Penalty Administration Is Broken (cont'd)

- The IRS treats timely filings untimely and penalizes them
  - Ueland v. United States, docket no. 1:23-cv-00931 (Court of Federal Claims)
  - IRS ignored the filing of a Form 7004 extension of time to file and treated Form 3520-A as untimely
  - IRS penalized taxpayers nearly \$100,000 for timely filing of Forms 3520-A reporting Australian Superannuation funds
  - IRS took nearly \$100,000 from the next year's refund for the penalty
  - IRS failed to notify taxpayers of penalty assessment
  - IRS failed to provide penalty computation under I.R.C. sec 6751(a)
  - IRS failed to establish a supervisor approved the penalty in writing prior to assessment under I.R.C. § 6751(b)(1)
  - IRS Independent Office of Appeals lost request appealing penalty
  - Taxpayers were forced to hire attorneys and sue
  - DOJ Tax Division conceded the case without filing a responsive pleading

# IRS Penalty Administration Is Broken (cont'd)

- The IRS ignores the law concerning reasonable cause
  - Wrzeninski v. United States, case no. 2:22-cv-03568-CFK (E.D. Penn.)
  - Mr. Wrzeninski received \$800,000 in gifts from mom in Poland after mom won the Polish lottery. Gift made in 4 transfers in 2010 and 2011.
  - Mr. Wrzeninski told return preparer about gifts and relied on his return preparer in failing to report the large foreign gifts
  - Later Mr. Wrzeninski was advised of the requirement to file Form 3520 pursuant to I.R.C. § 6039F
  - Mr. Wrzeninski relied on the Old DIIRSP and filed delinquent Forms 3520
  - IRS assessed the maximum penalties
  - Appeals offered a hazards of litigation settlement not accepting reasonable cause for late reporting
  - Appeals abated \$70,000 of the \$87,000 penalty assessed for tax year 2010 and \$96,000 of the \$120,000 penalty assessed for tax year 2011 (2010 abatement ratio was 80.4% abated v. 19.6% sustained and 2011 abatement ratio was 80% abated v. 20% sustained)
  - DOJ Tax Division conceded the case without filing a responsive pleading



# IRS Penalty Administration Is Broken (cont'd)

- Penalty computations are often wrong
- At times IRS notices reference completely incorrect penalties
  - Late Form 3520-A reporting foreign trust, IRS assessed a penalty under § 6725 for failure to report a vessel or facility under § 4101(d)
  - In other words, IRS penalty assessments can be completely disconnected from reality
- No consideration of facts if submitted with late filings
- IRS approach is to penalize at maximum levels and force taxpayers to beg for relief through a lengthy administrative process

# Typical Process for Systemic Penalties involving Forms 3520 and 3520-A

- Late filing of Form 3520/3520-A with reasonable cause statement
- Penalty assessed at maximum rates; Ogden ignores reasonable cause
- Ogden issues Penalty Notice CP15 “Notice of Penalty Charge”
- Appeal “Notice of Penalty Charge” within 30 days with reasonable cause
- **IRS Collection begins efforts to collect the assessed penalty**
- Ogden issues letters 2644C notifying it needs time to consider submission
- Ogden denies reasonable cause and issues a Letter 854C
- Appeal Letter 854C within 60 days for review by the Independent Office of Appeals (Appeals)
- Case enters queue for Appeals

# Common Compliance Mistakes

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# Common Mistakes

- Failing to identify an information return is due
- Form 5471 – Overlooking constructive ownership/attribution rules; mistaking foreign entity default rules; § 965 Transition Tax; not identifying all applicable filer categories; adjusting financials for GAAP
- Form 3520 – Failing to timely report large foreign gifts and inheritances; not disclosing U.S. owner of foreign trust; failure to disclose distributions from foreign trusts (e.g., uncompensated use of trust property, loans that are not qualified obligations); failing to timely file by 10/15 for taxpayers residing abroad with 12/15 filing deadlines.



# Common Mistakes (cont'd)

- Form 3520-A
  - Failing to timely file because the deadline is not the same as the deadline for Form 1040 unless it is filed as a substitute Form 3520-A
  - Not filing Form 7004 to request an extension of time to file for Form 3520-A
  - Failing to indicate at the top of Form 3520-A that it is a fiscal year filing
  - Failing to use most recently assigned EIN if IRS assigned an EIN

# Common Mistakes (cont'd)

- Misclassifying foreign pensions and other plans as exempt from Form 3520 and Form 3520-A reporting under Rev. Proc. 2020-17
  - See Rev. Proc. 2020-17 § 5.03 (tax-favored retirement trusts) and § 5.04 (tax-favored foreign non-retirement savings trust)
  - Critical requirements:
    - “Only contributions with respect to income earned from the performance of personal services are permitted”
    - Specific annual / lifetime contribution limits
  - Some practitioners are ignoring/stretching the requirements for relief

# Common Mistakes (cont'd)

- Form 8621 – Failing to identify an investment as foreign mutual fund subject to PFIC reporting
- Form 8938 – Failing to report less common foreign financial assets such as stock in foreign corporations, foreign pensions, promissory notes issued by foreign persons, interests in foreign estates
- Form 8854 – Long term permanent residents surrender green card triggering mark-to-market exit tax
- FBAR – Overlooking certain familial arrangements for foreign bank accounts where taxpayer either has authority over the account or is named as beneficial owner of the account
- Form 5472 – Failing to file pro-forma Form 1120 and Form 5472 for foreign owned domestic disregarded entity

# Malpractice Considerations

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# CPA Malpractice and Ethical Considerations

- Comprehensive client questionnaire that addresses international reporting issues
- Follow up on client questionnaires
- Engagement letter for every tax year



# Limited Scope Engagements

- **Circular 230 §10.33 (a)(1)**
  - Provides that tax advisors must clearly communicate the terms of engagement and determine the client's expected purpose and use of advice -- “clear understanding regarding the form and scope of the advice or assistance to be rendered.”
- **ABA Model Rule 1.2(c):** “A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.”

# Limited Scope Engagements

- Informed Consent
  - ABA Model Rule 1.0 (e) “denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.”
- In writing
  - Must be clear as possible. Ensure client understands the consequences of what they are signing

# Limited Scope Engagements

- Enforceable: *AmBase Corp v. Davis Polk & Wardwell*:
- Facts: Law firm successfully litigated an IRS tax dispute but was subsequently sued by the client for malpractice for failing to question whether an agreement between the client and related company relieved the plaintiff of the tax liability.
- **Holding**: Law firm was retained to litigate the amount of the tax liability with the IRS and not issue of whether the client owed underlying liability.



# Limited Scope Engagements

- **Not Enforceable:** *Nichols v. Keller.*
- Facts: attorney representing client in workers comp. claim was found negligent for failing to advise client about a potential tort action and the attendant statute of limitations on those claims.
- Holding: The representation was limited to the workers comp claim, however, the court found that: (1) Attorney needed to disclose that there may be other remedies the attorney is not looking into; (2) Disclose any apparent legal problems pertaining to the limited scope of service; and (3) Advise the client to find different counsel for the other issue (and make a note of it too)

# Limitation of Liability Clauses

- CPA Engagement Agreements often include limitation of liability clauses to limit potential liability to fees for services or a multiple of fees for services.
- Sample: You agree that you have been made aware of the inherent risks and benefits of this Agreement. As such, you agree, to the fullest extent permitted by law, to **limit the liability** of [CPA firm] for any and all claims, losses, costs, and damages of any nature whatsoever that relate to this Agreement, so that the total aggregate liability of [CPA firm] **shall not exceed [CPA firm] total fee for services rendered** under this Agreement. It is the intent of you and [CPA firm] that this limitation apply to any and all liability or cause of action against [CPA firm], however alleged or arising, unless otherwise prohibited by law.

# Limitation of Liability Clauses

- **Gross Negligence "Exception"**: “a party may not insulate itself from damages caused by **grossly negligent conduct**.”
- Grossly negligent conduct “evinces a reckless indifference to the rights of others,” such as when an employee acts (or fails to act) without regard to the harmful consequences to the client.
- *For example*: Environmental consultant was grossly negligent for failing to disclose “the presence of 38 drywells, containing potential contaminants, on plaintiff’s property, despite the availability of this information in the public records.”
- For accountants performing attestation services, gross negligence arises when the accountants are aware of circumstances casting doubt on a company’s information, know that additional procedures should be performed, “but never perform[] such procedures.”

# Other Malpractice Considerations

- Choice of Law/Choice of Forum Matters – State law (place of forum) generally governs when the statute of limitations on claims against CPAs accrue.
  - New York- Good for CPAs (3 years from receipt of work product)
  - Florida- Bad for CPAs (2 years from conclusion of IRS dispute).
- Mandatory Arbitration/Mediation
  - Contractual Statute of Limitations - "You accept and acknowledge that any demand for arbitration arising from the Services must be issued within one year from the date you became aware or should reasonably have become aware of the facts giving rise to liability but, in any event, no later than two years after the cause of action accrued."
- Attorney's Fees - "Loser pays" provisions

# CPA- Will Your Firm Help Pay Legal Costs in IRS Dispute?

- Assume CPA firm's mistake generated a large penalty assessment.
- What are the pros/cons of the CPA chipping in to pay for legal fees in the IRS penalty dispute?



# Representatives Handling Penalty Disputes Malpractice and Ethical Considerations

- Keep the variance doctrine in mind and make all arguments to the IRS to preserve them for future litigation
  - Treas. Reg. §301.6402-2(b)(1) “The claim must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof. ...”
  - Courts will bar claims that substantially vary from refund claim presented to IRS
- Decide on whether to provide advice on potential malpractice claims
  - Consider excluding advice on malpractice claims in your engagement letter
    - Sample language: This engagement does not include advice on any potential malpractice claims against accountants.
    - Document referral to malpractice attorney if you have reason to believe client may have a claim
  - Watch for “engagement creep”

# Representatives Handling Penalty Disputes Malpractice and Ethical Considerations (cont'd)

- Tolling agreements for CPA issues
  - Option 1: Prepare tolling agreement to provide service to your client
  - Option 2: Refer clients to malpractice counsel for tolling agreements
- Send CPA written release signed by client authorizing CPA to discuss and provide tax returns and workpapers
- When interviewing third parties such as CPAs that made mistakes, make clear you are not providing them legal advice
- When preparing declarations or affidavits of CPAs that made mistakes, document that you want them to be truthful and comfortable with the sworn statements

# Post-Assessment Penalty Strategies

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# Compliance Options for Taxpayers with International Information Return Issues

1. Streamlined Filing Compliance Procedures
  - Streamlined Foreign Offshore
  - Streamlined Domestic Offshore
2. Filing Amended/Delinquent Returns (a.k.a. “quiet disclosure”)
3. Prospective compliance (a.k.a. “silent disclosure”)
4. Delinquent FBAR Submission Procedures- still viable if fully tax compliant
5. Voluntary Disclosure Practice

# Appeals Settlement Possibilities for International Penalties

- First Time Abate
- Reasonable cause
- § 6751(b)(1) supervisory approval
- Hazards of litigation
- Penalty mitigation

See generally IRM 8.11.1 “Return Related Penalties in Appeals”



# Other Arguments to Raise

- § 6751(a) lack of penalty computation
- Reliance on IRS FAQs or oral advice
- Constitutional Due Process



## Policy Statement 8-47 at IRM 1.2.1.9.6

“Appeals will ordinarily give serious consideration to an offer to settle a tax controversy on a basis which fairly reflects the relative merits of the opposing views in the light of the hazards which would exist if the case were litigated. However, **no settlement will be made based upon nuisance value of the case to either party.** If the **taxpayer makes an unacceptable proposal** of settlement under circumstances indicating a good-faith attempt to reach an agreed disposition of the case on a basis fair both to the Government and the taxpayer, the Appeals official generally should give an **evaluation of the case in such a manner as to enable the taxpayer to ascertain the kind of settlement that would be recommended for acceptance. ...**”

# First Time Abate (FTA)

- For general information, see <https://www.irs.gov/payments/penalty-relief-due-to-first-time-abate-or-other-administrative-waiver>
- **General rule:** FTA does not apply to IIR penalties. IRM 8.11.5.1 (12) Note states: “The First Time Abatement (FTA) administrative waiver is not applicable to International Penalties addressed in IRM 8.11.5.”
- **Exception:** IRM 20.1.9.3.5(3) noted that if FTA is provided for the associated Form 1120 or Form 1065, then FTA may be provided for Form 5471 penalties if no similar penalties in the last three years and Form 1120/Form 1065 not filed late in the last three years.
  - December 7, 2022 John Hinding Memo to Appeals regarding FTA for systemic Form 5471 and Form 5472 penalties

# Reasonable Cause

- Generally all or nothing resolution
- Appeals often considers
  - Taxpayer compliance history
  - Length of time to come into compliance
- Appeals has favorite cases to cite and consider in nearly all reasonable cause disputes
  - Appeals training material provides a good roadmap of cases to address
  - Key portions of Appeals' training material that was released in a FOIA is available at <https://www.pricetaxlaw.com/penalty-abatement>

# Reasonable Cause (cont'd)

IRM 20.1.1.3.2.2.6 (11-25-2011) provides the following factors to consider in the context of mistakes based on ignorance of the law:

(1) In some instances taxpayers may not be aware of specific obligations to file and/or pay taxes. The ordinary business care and prudence standard requires that taxpayers make reasonable efforts to determine their tax obligations. ...



# Reasonable Cause (cont'd)

IRM 20.1.1.3.2.2.6(2) Reasonable cause may be established if the taxpayer shows ignorance of the law in conjunction with other facts and circumstances. For example, consider the following:

- a. The taxpayer's education.
- b. If the taxpayer has previously been subject to the tax.
- c. If the taxpayer has been penalized before.
- d. If there were recent changes in the tax forms or law which a taxpayer could not reasonably be expected to know.
- e. The level of complexity of a tax or compliance issue.

# Reasonable Cause (cont'd)

- United States v. Boyle, 469 U.S. 241 (1985)
  - The timely filing of a tax return is not excused by the taxpayer's reliance on an agent
- Neonatology Assocs., P.A. v. Commissioner, 115 T.C. 43, 98–99 (2000), aff'd, 299 F.3d 221 (3d Cir. 2002)
  1. the advisor is competent
  2. the taxpayer provided necessary and accurate information to the advisor
  3. the taxpayer relied in good faith on the advisor

# Documenting the Neonatology Factors

1. The advisor is competent
  - A. Firm website
  - B. LinkedIn profiles
  - C. Articles and blogs
2. The taxpayer provided necessary and accurate information to the advisor
  - letter, declaration, or affidavit from the CPA admitting error and admitting taxpayer provided all information requested
  - CPAs are naturally reluctant to admit error
  - Delicate negotiations are required to obtain written admissions of error

# Documenting the Neonatology Factors (cont'd)

3. The taxpayer relied in good faith on the advisor
  - A. Written statement from CPA can address this factor
  - B. Explain the taxpayer's reliance in the protest in detail

# Drafting Tips Reasonable Cause Statements

- Put effort into the abatement request: identify the issue, include all the facts, summarize the law and policy, and apply the law and policy to the facts
- Write the facts to fit into the theme of “reasonable cause” as developed by caselaw
- Humanize your client and tell a story
- Argue the equities and any other compelling facts to support your reasonable cause request
- Stacy Caplow, *Putting the “I” in Writing: Drafting an A/Effective Personal Statement to Tell a Winning Refugee Story*, 14 Legal Writing: J. Legal Writing Inst. 249 (2008).
  - Draft a moving personal account in the first person
  - Persuade a jaded decision maker to grant relief
  - Article has some good tips on writing a compelling story



# IRC § 6751(b)(1)

Confirm written supervisory approval of penalties.

IRC § 6751(b) states: “No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the **immediate supervisor** of the individual making such determination or such higher level official as the Secretary may designate.”



# IRC § 6751(b)(1) supervisory approval

- Generally all or nothing resolution
- Appeals Officers should verify timing of penalty approval by locating source document in administrative file
  - Not explicit but implicit at IRM 8.11.1.2.1
- For international information return penalties, locating source document may be difficult for Appeals
- Practitioner best practice- explicitly raise supervisory approval in protest

# IRC § 6751(b)(2)

Exceptions to written supervisory approval of penalties under IRC § 6751(b)(2):

(A) any addition to tax under § 6651, 6654, 6655, or 6662 (but only with respect to an addition to tax by reason of subsection (b)(9) thereof); or

(B) any other penalty **automatically calculated through electronic means**

- IRS position is that some international information return (IIR) penalties are automatically calculated through electronic means including some Form 5471 and Form 5472 penalties.





# FOIA to Optimize § 6751(b)(1) Presentation to Appeals

- As soon as you anticipate a penalty dispute, send the IRS a FOIA for § 6751(b)(1) documents concerning written supervisory approval
- In context of IIRs that are campus assessed, highly likely that IRS will not produce actual record satisfying § 6751(b)(1)
- Appeal the FOIA production
- In the Appeals protest on the penalties, provide Appeals the records obtained in FOIA to make the Appeals Officer's job easier

# Freedom of Information Act Request Relating to IRC § 6751(b)

- Was supervisory approval documented in writing?
- Was supervisory approval timely?
- Do you suspect penalty backdating?
- Was person who provided written approval a supervisor as required by the IRC?



# Hazards of Litigation

- IRM 8.11.1.2.7.5 states:
  - (4) The hazards of litigation are the uncertainties of the outcome of the court's decision in the event of a trial.
  - (5) Litigating hazards generally fall into three categories: factual, legal and evidentiary. Note: Lack of case law should not be considered a hazard of litigation.
- Factual hazards- salient facts are unclear as to whether the taxpayer meets reasonable cause. Examples:
  - Taxpayer claims he was ill at the time a return was due, but the facts are inconclusive
  - Taxpayer filed a return 10 days late and the facts are inconclusive regarding whether he timely postmarked his filing.
- Legal hazards- status of case law, law of circuit, etc.
- Evidentiary hazards- (admissibility, willingness/availability of witnesses)

# Hazards of Litigation - Wrzesinski

- I.R.C. § 6039F penalty refund case
- Appeals offered a hazards of litigation settlement for a case that appears to have textbook reasonable cause for late reporting
- Taxpayer received \$800,000 in gifts from mom in Poland after mom hit the Polish lottery. Gift made in 4 transfers in 2010 and 2011.
- Taxpayer relied on EA's advice that gift was not taxable or reportable
- Later discovered requirement to report on Form 3520 and used DIIR to file late Forms 3520
- IRS assessed maximum penalties
- Appeals abated \$70,000 of the \$87,000 penalty assessed for tax year 2010 and \$96,000 of the \$120,000 penalty assessed for tax year 2011
  - 2010 abatement ratio was 80.4% abated v. 19.6% sustained
  - 2011 abatement ratio was 80% abated v. 20% sustained
- DOJ Tax Division conceded the case without filing a responsive pleading - March 2023.

# The Mystery of Mitigation in Appeals

- Tax Analysts made a FOIA request to the IRS on Appeals' training material on international penalties
- FOIA production shed light on trend observed by practitioners
  - How do I get this Appeals' training material?  
<https://www.pricetaxlaw.com/penalty-abatement>
- Essence of mitigation:
  - Compelling facts that do not equate to reasonable cause
  - Significant portion of penalty is abated
  - IRS wants taxpayer to feel some pain to “learn”

# The Mystery of Mitigation in Appeals (cont'd)

- Practitioners have observed Appeals International forcing taxpayers with reasonable cause or highly sympathetic facts to eat 25-40% of assessed penalties in settlements
- Product of Appeals' "review and concurrence" process for certain issues
- See IRM 8.7.3.4.1 Review and Concurrence
- Issue coordinators insulated from taxpayer contact, may be overconfident in government's position, ignorant of caselaw, jaded, or cavalier
- When issue coordinators don't approve reasonable cause, Appeals Officers are left with mitigation

# The Mystery of Mitigation in Appeals (cont'd)

- Formally adopted in FBAR context by Exam – IRM Exhibit 4.26.16-2
- Minimal or no hazards
- Extenuating circumstances exist
- According to Appeals penalty training material:  
“Mitigation is available but should be used sparingly.”



# The Mystery of Mitigation in Appeals (cont'd)

- IRS Foundation for penalty mitigation
- Application of macro-level penalty policy to reduce the severity of the penalty
- IRM 20.1.1.2.1 “Encouraging Voluntary Compliance”
- IRM 20.1.1.2.1 (8) The IRS has the obligation to advance the fairness and effectiveness of the tax system.

Penalties should do the following:

- Be **severe enough to deter noncompliance**,
- Encourage noncompliant taxpayers to comply,
- Be objectively proportioned to the offense, and
- Be used as an opportunity to educate taxpayers and encourage their future compliance.

# Appeals Offers Your Client Mitigation

- You've established reasonable cause, the Appeals Officer hinted that you established reasonable cause, and then after "review and concurrence" the Appeals Officer offers a mitigated penalty. Is it game over?
- Ask for a managerial conference to elevate the disagreement over mitigation
- Managerial conferences in Appeals are discretionary
- See IRM 8.7.3.4.1 about review and concurrence: "If the settlement is not acceptable [to the reviewer], provides a written response (rebuttal) to the Appeals Officer. If agreement is not reached, the respective managers attempt to resolve the dispute. If the Appeals Team Managers (ATMs) cannot resolve the dispute, the ATMs will refer it to ..."
- Key - beg to get the ATM involved to push back against the reviewer

# Litigation – The Last Resort

- Appeals' unreasonableness on IIRs is forcing more taxpayers into costly litigation
- Pay penalty (or penalty was paid by refund offset)
- Request penalty to be refunded (Form 843)
- Sue for refund

# Litigation – The Last Resort (cont'd)

## Issues to consider

- Liquidity issues to pay penalty
- Costs of litigation and possibility of attorney fees
- Favorable facts to shame government and seek press attention (Wrzesinski or Ueland type facts may promote prompt government concession)
- Malpractice claim against CPA and tolling agreement
- Public record of litigation (especially for Form 3520 penalties, transactions indicating wealth will become known publicly and may jeopardize foreign family members' safety)

# About the Images in This Presentation

- Several images used in this presentation were AI generated using DALL-E2
- For more information on AI art, see <https://openai.com/dall-e-2>
- Sample- accountant smashing calculator with hammer with hammer
- Some images are useable, some are humorous

