



2023  
**MIDYEAR TAX  
MEETING**

**FEBRUARY 9-11  
SAN DIEGO, CA**

**From the Cradle to the Graev:  
What is next for section 6751(b)?**

**Court Procedure & Practice  
February 10, 2023**

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## The Panel

*Moderator: Daniel Strickland, Holland & Knight*

*Panelists: Judge Ron Buch, United States Tax Court*

*Dan Price, Law Offices of Daniel N. Price, PLLC*

*Josh Wu, Latham & Watkins*

# Objectives

After attending the session, the participant will be able to:

- Explain the statutory requirements for penalty approval
- Identify the nuances created by recent caselaw that apply in different appellate circuits
- Understand how to handle the question of supervisory approval in the context of tax litigation

# The Statute

## The Statute: Section 6751(b)

“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.”

I.R.C. § 6751(b)(1).

Exceptions:

- Failure to File, Failure to Pay, and Failure to Pay Estimated Tax Penalties
- Any “penalty calculated through electronic means.”

IRC § 6751(b)(2).

## Section 6751(b): Statutory History

- Added to the Internal Revenue Code as part of the IRS Restructuring and Reform Act of 1998
- Purpose: to prevent the IRS from using unapproved penalties as a ***bargaining chip***.
  - Senate Report: “Penalties should only be imposed where appropriate and not as a bargaining chip.”
  - Joint Committee Report: IRS must present evidence that “it is appropriate to apply a particular penalty to the taxpayer before the court can impose a penalty.”
  - Conference Report: “The IRS must treat the American people with respect.” “[This bill] will help protect taxpayers by increasing oversight, holding IRS employees accountable and insuring taxpayers are treated with fairness”

## Parsing the Statute

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.

# Penalty Approval

*When is the deadline for penalty approval?*



# Caselaw

## Graev II

### *Graev v. Commissioner*

147 T.C. 460 (2016), vacated, 149 T.C. 485 (2017)

**When:** Anytime before assessment.

**Holding:** Finding that the issue is not “ripe” for determination under the Tax Court’s pre-assessment review because the plain reading of the statute merely requires approval before assessment.

# Chai

## *Chai v. Commissioner*

851 F.3d 190 (2d Cir. 2017)

**When:** No later than the date the IRS sends a Notice of Deficiency.

## Graev III

### *Graev v. Commissioner*

149 T.C. 485 (2017), vacating 147 T.C. 460 (2016)

**When:** No later than the date the IRS sends a Notice of Deficiency; **Reverses** its holding in *Graev II*.

# Clay

## *Clay v. Commissioner* 152 T.C. 223 (2019)

**When:** No later than (1) the date on which the IRS issues the notice of deficiency or (2) the date, if earlier, on which the IRS formally communicates to the taxpayer the Examination Division's determination to assert a penalty and notifies the taxpayer of his right to appeal that determination.

# Belair Woods

## *Belair Woods, LLC v. Commissioner* 154 T.C. 1 (2020)

**When:** No later than when the IRS sends a letter “formally notifi[ng]” the taxpayer that “the Examination Division had completed its work and \* \* \* had made a definite decision to assert penalties.”

# Laidlaw

## *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner* 29 F.4th 1066 (9th Cir. 2022)

**When:** At anytime when the supervisor still has discretion to withhold approval (before assessment).

**Holding:** No textual basis requiring approval before the IRS “formally communicates” a proposed penalty to a taxpayer. Specifically rejects that approval is needed before the IRS sends the 30-day letter.

# Kroner

## *Kroner v. Commissioner*

48 F.4th 1272 (11th Cir. 2022)

**When:** Before the assessment is made.

**Holding:** “[N]othing in the text . . . requires a supervisor to approve penalties at any particular time.”



## Parsing the Statute

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.

# Minemyer

## *Minemyer v. Commissioner* No. 21-9006 (10th Cir. 2023)

**When:** With respect to civil penalties, “on or before the date the IRS issues a notice of deficiency.”

**Holding:** No textual basis requiring approval before the IRS “formally communicates” a proposed penalty to a taxpayer.

# Practical Strategies

# Administrative Controversy

- Generally there is an all-or-nothing resolution.
- Appeals Officers should verify timing and all other elements 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 documents for campus assessed penalties may be difficult for Appeals.
- Practitioner best practice: Explicitly raise supervisory approval in protest.

# International Information Return (IIR) Penalties

- IRS procedures for campus-assessed IIR penalties are designed for processing efficiency and have not always kept compliance with section 6751 in mind.
- Use FOIA as early as possible to secure documents relating to all elements of the penalty approval, including:
  - Timing of penalty approval;
  - Identity and authority of person who approved the penalty;
  - Penalty referenced in assessment; and
  - Tax period referenced in assessment.

## Automatically Calculated Through Electronic Means

- Section 6751(b)(2)(B) provides an exception from supervisory approval for “any other penalty automatically calculated through electronic means.”
- What is required for this exception?
  - Training material from the Independent Office of Appeals indicates that the IRS is actively seeking to classify penalties under sections 6038 and 6038A (relating to Forms 5471 and 5472) as automatically calculated through electronic means.

# Challenging the Presumption of Regularity

- The “presumption of regularity” creates a rebuttable presumption that government personnel followed all requisite steps and procedures.
- Recent case applying presumption in context of section 6751(b)(1): *Long Branch Land, LLC v. Commissioner*, T. C. Memo. 2022-2 (challenging the status of an acting supervisor who approved penalties).
- In context of supervisory approval, taxpayers must offer evidence to overcome presumption.

# Discovery

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

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



# Discovery

How can taxpayers determine whether they have a defense without discovery, particularly corporations and partnership who must affirmatively plead the defense?

- *Greenberg Express*. The Court will not look behind a notice of deficiency.
- Deliberative process. Protects predecisional and deliberative administrative documents and communications
- Courts have authorized limited discovery in certain circumstances.

# Litigation

## Burden of Proof (Persuasion)

- The Commissioner bears the burden of production with respect to the liability of any *individual* for any penalty.
  - The Commissioner does not bear the burden of production with respect to penalty in partnership-level proceedings and corporations.
- Satisfying this burden generally includes:
  - The identity of the individual who made the “initial determination”;
  - An approval “in writing” of the penalty at issue;
  - The identity of the person giving approval and his or her status as the “immediate supervisor”; and
  - Evidence that the supervisory approval was timely given.

# Litigation

## Pleading standards

- Where the Commissioner does not bear the burden of production as to penalties, the lack of supervisory approval of penalties must be raised as a defense to those penalties.
- If section 6751 is not raised as a defense, it will be deemed waived on appeal or in a motion for reconsideration.
- ***Note for refund litigation:*** There is a requirement to file a claim for refund and raise the defense.

# Looking Forward

# Crystal Ball

In the Ninth Circuit, both assessable penalties and penalties subject to deficiency procedures must be approved while the supervisor still has discretion to withhold approval.

## **Congress: Potential for repeal?**

Build Back Better Act, H.R. 5376, § 138404

Consolidated Appropriations Act, 2023, P.L. 117-328, § 605

## **Courts: Unified theory or Supreme Court decision?**

## **Regulations: Is there ambiguity for clarifying guidance?**

# Questions?