

Tax Notes obtained the following material from the IRS pursuant to a Freedom of Information Act request. For news coverage about this material, please see Andrew Velarde's article "IRS Appeals Training Materials on Reasonable Cause Bring Worry" published on October 6, 2022.

The original production included 367 pages. We de-duplicated the material reducing what follows to 344 pages. But many of the slides still substantially overlap, sometimes with very minor changes.

Most of the slides are text searchable, and we encourage you to search for key words such as case names (e.g., Boyle and Neonatology) and unique terminology (e.g., mitigation and "review and concurrence").



Introduction

Introduce myself and my role as Coordinator for this issue.

Motivation for this topic – Lots of Campus foreign trust penalty work. Hopefully these IDRS and AMS tips will help work these cases more efficiently. Strongly encourage AO's to get IDRS and AMS access if they work these cases.



Learning Objective:

By the end of this workshop, you should have a better understanding of how to use IDRS and AMS to work through foreign trust and foreign gift/inheritance penalty cases in Appeals.

Transition to next topic – 45 day check-in procedures.



IDRS/AMS Research – Form 3520 & 3520-A PENAP cases

Working the case:

- Timely filing disputes
- 6751(b) disputes – Campus cases
- Reasonable cause
- Multiple foreign trust filings – which one(s) source of penalty?

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Ask for volunteers to provide cases that have these issues. If no volunteers, use (b)(3):26 U.S.C. § 6103 (b)(3):26 U.S.C. § 6103 just to illustrate, even if these cases don't have these disputed issues.

Transition – timely filing disputes



IDRS/AMS Research – Form 3520 & 3520-A PENAP cases

Timely Filing Disputes – Form 3520:

- IDRS
 - Filing date
 - Check BMFOL-T, MFT 68, TIN with "V" at the end (i.e. 123-45-6789V), TC 150 date, Plan Number
 - Extensions
 - May post on BMFOL-T, if not, check related income tax return (i.e. IMFOL-T, MFT 30)
 - Copies of 3520 filings
 - TRDBV command code

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Ask for volunteers to provide cases that have these issues.

First bullet point – may or may not see multiple BMFOL-T's for same tax year, if multiple 3520 filings. Use (b)(3):26 U.S.C. § 6103 if no volunteer.

Second bullet point – I've seen instances of extensions on related income tax returns not posting on the 3520 BMFOL-T.

Third bullet point – This command code will show all of the 3520 filings for this TP, even if BMFOL-T only shows one MFT 68 filing. This command code often shows the first filing as the original filing, with the others as duplicate filings, but not always. Use (b)(3):26 U.S.C. § 6103 if no volunteer.



IDRS/AMS Research – Form 3520 & 3520-A PENAP cases

Timely Filing Disputes – Form 3520:

- AMS
 - Look for imaged copies of the return under MFT 68. Check the IRS date stamp for received date. Check for a postmark date on return envelope.
 - If nothing found under MFT 68, check under MFT 55 (individual TP)

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Ask for volunteers to provide cases that have these issues. If no volunteers, use (b)(3):26 U.S.C. § 6103 just to illustrate, even if these cases don't have these disputed issues.

First bullet – let class know that there may or may not be an imaged 3520 available.

Second bullet – let class know that Campus sometimes images 3520's under the MFT 55 instead of 68. It's possible no 3520'



IDRS/AMS Research – Form 3520 & 3520-A PENAP cases

Timely Filing Disputes – Form 3520-A:

- Need the trust EIN
 - Ways to locate trust EIN
 - IRS correspondence (check admin file or AMS images)
 - 3520 TRDBV
 - 3520 in AMS images
 - Ask TP or POA
 - Last resort – ask (b)(6) to check CIS
- IDRS, BMFOL-T, TRDPG, MFT 42, EIN, extension only on MFT 42
- AMS images of 3520-A's (MFT 42 or possible MFT 55)

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Ask for volunteers to provide cases that have these issues. If no volunteers, use (b)(3);26 U.S.C. § 6103 just to illustrate, even if these cases don't have these disputed issues.

Even if the trust didn't apply and receive an EIN, the IRS has been issuing EIN's to foreign trusts after filings of 3520 & 3520-A's.

(b)(6) is the only person in Area 11 with CIS access. CIS access was provided for this reason.

Last 2 bullets – see prior slide for 3520's, similar process (flip back to 3520 slide). If no record of extension on MFT 42, check TRDBV under EIN for possible mis-posting.

Transition to next topic – 6751(b)



IDRS/AMS Research – Form 3520 & 3520-A PENAP cases

Reasonable Cause:

- Compliance history
 - IDRS – BMFOL-I provides prior and subsequent year filing info
 - IDRS – IMFOL-I MFT 55 for any prior penalties
- Length of time to get into compliance
 - IDRS current year TC 150 date or AMS images of return – compare against TP written testimony

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Ask for volunteers to provide cases that have these issues. If no volunteers, use (b)(7)(E) (b)(3)-26 U.S.C. § 6103 just to illustrate, even if these cases don't have these disputed issues.

First bullet point – (b)(7)(E) would negate an ignorance of the law argument

Second bullet point – used to corroborate or establish timeline, possibly evaluate credibility

Transition to next slide – determining source of penalties, multiple foreign trust information return filings



Source of Penalties (if multiple trust filings):

- What if Taxpayer penalized for late filing for some (but not all) of late filings of foreign trust information returns?
 - Research AMS History notes
 - If AMS History notes aren't sufficient, ask me to check CIS

Ask for volunteers to provide cases that have these issues. If no volunteers, use (b)(3):26 U.S.C. § 6103 just to illustrate.

Unless all foreign trust late filings subjected to penalties on applicable taxpayer, have issue of determining which trust(s) source of penalties. Penalty notices don't provide such information.

AMS History notes help determine which trusts are source of penalties, I can check CIS if you can't determine based on your AMS research.

Transition – Second knowledge check question

Time check – need to be around 2 hr, 45 min.



Question #2

In what ways can IDRS and AMS assist you in working your foreign gift/inheritance or foreign trust penalty case disputed issues?

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Ask for different volunteers than Question #1 to read and answer. Multiple answers available.

Answers – 1) timely filing disputes, 2) 6751(b) disputes, 3) reasonable cause disputes, and 4) determining source of the foreign trust penalties for multiple trust filings

Transition – to summary



Foreign gift/inheritance penalties

- Learning Objectives
 - 1) Learn the administrative and procedural requirements for working foreign gift/inheritance penalty cases in Appeals
 - 2) Increase technical knowledge in the area of foreign gift/inheritance penalties

This is our second presentation in a series focused on sharing information and practices to improve our work quality and practices. Last month addressed penalty appeals. Today we are focused on our work centered around claim cases both administrative and technical.



Foreign gift/inheritance penalties

- Appeals coordinated issue, requiring review and concurrence
 - Primary – (b)(6)
 - Secondary – (b)(6)
 - Provide coordinator with copies of Gov't position and protest with ACM
 - Per IRM, Coordinator can waive requirement to provide Gov't position and/or protest (case by case basis during COVID)
- Issue Locator
 - <https://organization.ds.irsnet.gov/sites/APPEALS-PQCS/Lists/IssueLocator/AllItems.aspx>

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Foreign gift/inheritance penalties

- Form 13881 referral required
 - Provide information about related Appeals cases in referral
 - Submit in ACDS prior to submitting case to coordinator for R&C
- Source of cases
 - Campus
 - Gov't position on 854c letter
 - Penalties assessed after late filed Form 3520 Part IV
 - Protest in response of 854c letter
 - Field
 - Gov't position on leadsheet and/or Form 886-A, provided with 30-day letter
 - Penalties assessed during Exam case closure via Form 8278
 - Penalty amounts assessed should match Form 8278
 - Protest in response of 30-day letter

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Foreign gift/inheritance penalties

- IRM 8.11.5 International Penalties
 - IRM 8.11.5.6 Form 3520, part IV penalties
 - Filed with Ogden Service Center
 - Post-assessed, pre-payment appeal rights
 - If penalties not assessed before case gets to Appeals, release jurisdiction to Compliance as premature referral
 - FYI - Statute of limitations for assessment of penalties is three years from date of delinquent return filing
 - Penalties for late or incomplete filing
 - Assessed on MFT 13 (Business) or 55 (Individual), TC 240
 - Unique 3 digit PRN - 668
 - <http://serp.enterprise.irs.gov/databases/irm.dr/current/e6209/civil-penalty-reference-numbers.html?code=668&theRow=123>
 - Worked as PENAP cases (see IRM 8.11.4)

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Foreign gift/inheritance penalties

- Common Disputed Issues in Appeals
 - Reasonable cause IRC Section 6677(d)
 - Depends on facts and circumstances of each case
 - No case law directly on point
 - No 3520 Part IV reasonable cause court decisions
 - Common arguments for reasonable cause
 - Ignorance of the law
 - Form 1040 instructions for "Other Income" contain a short paragraph about this requirement
 - Off-the-shelf tax preparation software programs (i.e. Turbo Tax) may or may not provide references/assistance regarding this requirement
 - Reliance upon advice of a tax professional
 - *Neonatology Associates, P.A. v. Commissioner*, 115 TC 43 98-99 (2000), aff'd 299 F.3d 221 (3d Cir. 2002)

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Foreign gift/inheritance penalties

- Neonatology
 - It is a 3-prong test, with all 3 parts needing to be satisfied.
 - #1 – a competent professional with sufficient expertise was consulted
 - #2 – taxpayer provided the advisor with accurate and complete information
 - #3 – Taxpayer reasonably relied in good faith on the advice provide
 - This case cited on a Form 5471 reasonable cause case, where the argument was reliance on advice of a tax professional for late filing
 - *Edward S. Flume v. Commissioner*, TC Memo 2017-21

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Foreign gift/inheritance penalties

- No filing requirement
 - Reportable gifts/inheritance below filing thresholds (see prior slides)
 - Amounts received were not entirely gifts, but were something else (in full or in part) - i.e. loans, capital contributions, compensation, etc.
 - Gift tax law governs, facts/circumstances – considered consulting with Appeals Estate/Gift (E&G) Specialist
 - Valuation of non-cash gifts in dispute
 - Strongly consider consulting with an Appeals valuation specialist (i.e. Engineer or Economist)
 - Timing (reporting year) of when gift/inheritance made – (consider Appeals E&G referral)
 - NRA father and U.S. person daughter jointly owned foreign bank accounts for many years after daughter added to accounts by father, father later dies, daughter inherits accounts in year of death.
 - No foreign gift in year she was added to account, foreign inheritance in year of death, if daughter never used funds before dad's death.
 - Foreign gift in year(s) daughter withdrew any money from accounts for her own use

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Foreign gift/inheritance penalties

- Penalty amounts should be mitigated
 - FBAR penalties have Exam mitigation guidelines (IRM 4.26.16.6.6)
 - 5471 and 5472 penalties may be mitigated by International AO's, depending on facts and circumstances
 - See International Appeals training dated 7/11/17, or contact SME (b)(6)
 - Foreign gift/inheritance penalties do not have a mitigation policy
- First Time Abatement (FTA)
 - IRM 8.11.5.1(12) – FTA doesn't apply to foreign gift/inheritance penalties
- 8th amendment violation arguments
 - See FBAR penalty case, U.S. v. Garrity, 123 AFTR 2d, 2019-941
 - Garrity case had both FBAR and related foreign trust penalties
 - Multiple field related international penalty cases

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Foreign Trust & Foreign Gift/Inheritance Penalties

- Appeals coordinated issues, requiring review and concurrence
 - Primary – (b)(6)
 - Secondary – Russell McGeehan
 - Provide coordinator with copies of Gov't position and protest with ACM
 - Per IRM, Coordinator can waive requirement to provide Gov't position and/or protest (case by case basis during COVID)
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Foreign Trust & Foreign Gift/Inheritance Penalties

- Form 13881 referral required
 - Submit in ACDS prior to submitting case to coordinator for R&C
- Origin of cases (how cases originate)
 - Campus
 - Gov't position on 854c letter (Note – If CDP case, may not be 854c letter)
 - Penalties assessed after late filed Form 3520 or Form 3520-A
 - Protest in response of 854c letter (Note – If CDP case, may only be a CDP filing)
 - Field
 - Gov't position on leadsheet and/or Form 886-A, provided with 30-day letter
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- IDRS and AMS Research
 - How can they assist in working various issues?
 - Timely filing disputes
 - Section 6751(b) issues – Campus cases only
 - Reasonable cause
 - Determining the source(s) of penalties when there are multiple foreign trust filings



Reasonable Cause:

- Compliance history
 - IDRS – BMFOL-I provides prior and subsequent year filing info
 - Prior year filing history likely negates ignorance of the law arguments
 - IDRS – IMFOL-I MFT 55 or BMFOL-I MFT 13 for any prior penalties
- Length of time to get into compliance
 - IDRS current year TC 150 date or AMS images of return – compare against TP written testimony
 - Used to corroborate or establish timeline, evaluate credibility



Source of Penalties (if multiple trust filings):

- What if Taxpayer penalized for late filing for some (but not all) of late filings of foreign trust information returns?
 - Penalty notices don't indicate which trust(s) are the sources of the penalties
 - Research AMS History notes & AMS Images
 - Notes may document which particular trust was the penalty source
 - If there was an AMS image of the return, then that trust was likely a penalty source
 - If AMS research isn't sufficient, ask me to assist



Burden of Production

Section 7491(c) Burden of production:

(c) Penalties Notwithstanding any other provision of this title, the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title.



Burden of Production

What about non-individual returns? Corporations, etc?

From Tribune Media:

"Generally, the Commissioner's determinations in a notice of deficiency or in an FPAA are afforded a presumption of correctness and the taxpayer bears the burden of proving the determinations incorrect. Rule 142(a); Welch v. Helvering, 290 U.S. 111,115 (1933). In a proceeding regarding the liability of an individual for a penalty, the Commissioner has the burden of production as to the penalty. Section 7491(c). The Commissioner generally bears the burden of production as to any penalty or addition to tax imposed on an individual but not as to one imposed on a corporation. . . . But because the Commissioner does not bear the burden of production under section 7491(c) as to penalties imposed on a corporation, he also does not usually bear the burden of production as to section 6751(b)(1) approval for a penalty determined against a corporation. *Dynamo Holdings Ltd. P'shipv. Commissioner*, 150 T.C. 224, 231-232 (2018). Likewise, the Commissioner does not usually bear the burden of production as to penalties, including as to section 6751(b)(1) approval, in a partnership-level proceeding."

Translation for business returns and TEFRA cases: SNOD is deemed to be correct. Once the taxpayer challenges the penalty, then the government must demonstrate a timely, written penalty approval.



Code Section 6751(b) Update

What penalties are computed/assessed through electronic means?

Form 5471 and 5472 are automatically assessed and therefore, there is no opportunity for any managerial approval prior to the assessment of these penalties. The campus subsequently becomes involved in reasonable cause considerations but there is no human involvement prior to assessment.

Most delinquency penalties are automatically assessed.

One article cited that of the \$27,346,036,000 in penalties that the IRS assessed between October 1, 2015 and September 30, 2016, only \$1,975,199,000 (or 7.22%) would be subject to Chai's section 6751(b)(1) review in Court.



Code Section 6751(b) Update

IRM 21.8.1.26.1(3) & (4) explain that delinquent Form 5471 penalties are automatically assessed when such forms are filed with delinquent Form 1120 returns.

IRM 21.8.2.21.1 (3) likewise explains that delinquent Form 5472 penalties are automatically assessed when such forms are filed with delinquent Form 1120 returns.



Code Section 6751(b) Update

Exceptions to Automatically Assessed Penalties:

IRM 20.1.1.2.3.2 addresses a penalty exception for penalties assessed under the automated underreporter program:

- (1) When the [IRC 6662](#) accuracy-related penalties for negligence and substantial understatement are assessed under the Automated Underreporter Program (AUR) without an employee independently determining the appropriateness of the penalty, the penalty is automatically calculated through electronic means and may be assessed without written managerial approval of the penalty.
- (2) However, if a taxpayer responds either to the initial letter proposing a penalty or to the notice of deficiency that the program automatically issues, an IRS employee must consider the response.
- (3) When considering the response, the employee must make an independent determination as to whether the response provides a basis upon which the taxpayer may avoid the penalty. Whether the employee decides to apply the penalty or not, the employee's independent determination of whether the penalty is appropriate means that the penalty is not automatically calculated through electronic means. Accordingly, [IRC 6751\(b\)\(1\)](#) requires written managerial approval of an employee's determination to assert the penalty.



Note in this example:

1. Automatic assessment occurs only if the taxpayer does not contest the liability/penalty.
2. If the liability/penalty is contested, an individual gets involved *before* assessment. Therefore, since an individual is involved prior to assessment, the penalty determination must have prior written, approval.



Form 3520 Penalties coming from the Campus are not automatically assessed:

20.1.9.10.2 (03-21-2013)

Penalty Letters, Notice Letters, and Notices

(1) **CP Notices**—Once a penalty is identified by the campus or a penalty case is closed by the field and the [Form 8278](#) is processed, a CP notice is generated and sent to the taxpayer as follows:

IMF—A [CP 15](#), *Notice of Penalty Charge*, for penalties assessed on **MFT 55** with **PRN 668** is generated and sent to the taxpayer. A sample of a [CP 15](#) notice (for a different penalty) is shown at [Exhibit 20.1.9-6](#), *Sample CP 15 Notice*.

BMF—A [CP 215](#), *Notice of Penalty Charge*, for penalties assessed on **MFT 13** with **PRN 668** is generated and sent to the taxpayer. A sample of a [CP 215](#) notice (for a different penalty) is shown at [Exhibit 20.1.9-7](#), *Sample CP 215 Notice*.

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Common delinquency penalty scenario:

**Taxpayer has been assessed a delinquency penalty.
There is no TC 460 on the account.**

Taxpayer argument:

But yes, I did timely file an extension!



IRC 6081 provides that the Secretary of the Treasury *may* grant a reasonable extension of time for filing any return, declaration, statement, or other document. Additionally, it provides that, except for taxpayers who are abroad, no such extension shall be for more than 6 months



§ 1.6081-1 Extension of time for filing returns.

- (a) In general. The Commissioner is authorized to grant a reasonable extension of time for filing any return, declaration, statement, or other document that relates to any tax imposed by subtitle A of the Internal Revenue Code (Code) and that is required under the provisions of subtitle A or F of the Code. However, other than in the case of taxpayers who are abroad or as specified in section 6081(b), such extensions of time shall not be granted for more than six months, and the extension of time for filing the return of a DISC (as defined in section 992(a)), as specified in section 6072(b), shall not be granted. Except in the case of an extension of time pursuant to § 1.6081-5, an extension of time for filing an income tax return shall not operate to extend the time for the payment of the tax unless specified to the contrary in the extension. For rules relating to extensions of time for paying tax, see § 1.6161-1.



Reasonable Cause –

Forms 8805

and 1042S

Objectives:

- 1. Identify the Relevant Code and Regulations that provide penalty and reasonable cause relief for the most recurring international penalties.**
- 2. Discover some unique reasonable cause regulation provisions that are applicable to some international penalties.**

Objectives (Continued)

- 3. Be able to describe the details of these reasonable cause provisions and be able to apply them.**

Penalty – Failure to File Form Number	Penalty Code Section	Reasonable Cause Code or Regulation
5471	6038	Treas Regulation 1.6038-2(k)(3)
5472	6038A	Treas Regulation 1.6038A-4(b)
3520	6048 6039	6677(d) 6039(F)(c)(2)
1042	6651	6651 & Treas Regulation 301.6651
8804	6651	6651 & Treas Regulation 301.6651

What About Forms:

8805??

1042-S??

Penalty – Failure to File Form Number	Penalty Code Section	Reasonable Cause Code or Regulation
8805	Code Section 6721	Code Section 6724 and Treasury Regulation 301.6724
1042-S	Code Section 6721	Code Section 6724 and Treasury Regulation 301.6724



Statutory Authorities

- **Code Section 6721:**

Provides for a penalty for the failure to file certain international information returns.
- **Code Section 6722:**

Provides for a penalty for the failure to furnish correct payee statements.
- **Code Section 6724:**

Provides for a general reasonable cause waiver.
- **Treasury Regulations 301.6724**

Provides the expansive criteria for reasonable cause relief.



Statutory Authorities

Code Section 6722:

Provides for a penalty for the failure to furnish payee statements.

Treasury Regulation 301.6722-1(a)(2)(i):

“A failure to furnish a payee statement on or before the prescribed date therefore to the person to whom such statement is required to be furnished (“failure to furnish timely”),....

We’re dealing with the failure to furnish payee statements.

Forms 8804 and 1042 are required annual tax returns. They are subject to the delinquency penalties under Code Section 6651.

(Example - Form 8804 is an annual return as defined in 1.1446-3.)



What is the penalty?

Treasury Regulation 301.6722-1(a)

Imposition of penalty

- (1) General rule. A penalty of \$50 is imposed for each payee statement (as defined in Section 6724(d)(2)) with respect to which a failure (as defined in section 6722(a) and paragraph (a)(2) of this section) occurs.



From IRM 20.1.7: (A summary)

Exhibit 20.1.7-1 (12-09-2019)

Exhibit 20.1.7-2 (12-09-2019)



Statutory Authorities

Returns Due	Penalty Rate	Not more than 30 days late	31 days late - August 1	After August 1	Intentional disregard**
From 01-01-2021 thru 12-31-2021* (Rev. Proc. 2019-44)	Per return / Max	\$50 / \$197,500	\$110 / \$565,000	\$280 / \$1,130,500	\$560 / No max
From 01-01-2020 thru 12-31-2020* (Rev. Proc. 2018-57)	Per return / Max	\$50 / \$194,500	\$110 / \$556,500	\$270 / \$1,113,000	\$550 / No max
From 01-01-2019 thru 12-31-2019* (Rev. Proc. 2018-18)	Per return / Max	\$50 / \$191,000	\$100 / \$545,500	\$270 / \$1,091,500	\$540 / No max
From 01-01-2018 thru 12-31-2018* (Rev. Proc. 2016-55)	Per return / Max	\$50 / \$187,500	\$100 / \$536,000	\$260 / \$1,072,500	\$530 / No max



Statutory Authorities

Code Section 6724:

- (a) Reasonable cause waiver No penalty shall be imposed under this part with respect to any failure if it is shown that such failure is due to reasonable cause and not to willful neglect.



301.6724-1 Reasonable Cause

(a) Waiver of the penalty -

(1) General rule. The penalty for a failure relating to an information reporting requirement (as defined in paragraph (j) of this section) is waived if the failure is due to reasonable cause and is not due to willful neglect.



301.6724-1 Reasonable Cause

- (2) Reasonable cause defined. The penalty is waived for reasonable cause only if the filer establishes that either -
- (i) There are significant mitigating factors with respect to the failure, as described in paragraph (b) of this section; or
 - (ii) The failure arose from events beyond the filer's control ("impediment"), as described in paragraph (c) of this section.



Statutory Authorities

Moreover, the filer must establish that the filer acted in a responsible manner, as described in paragraph (d) of this section, both before and after the failure occurred. Thus, if the filer establishes that there are significant mitigating factors for a failure but is unable to establish that the filer acted in a responsible manner, the mitigating factors will not be sufficient to obtain a waiver of the penalty. Similarly, if the filer establishes that a failure arose from an impediment but is unable to establish that the filer acted in a responsible manner, the impediment will not be sufficient to obtain a waiver of the penalty. See paragraph (g) of this section for the reasonable cause safe harbor for persons who exercise due diligence.



**How do we know that these 301.6724 regulations apply to
Forms 8805 and 1042-S?**



301.6724-1(j):

(j) Failures to which this section relates. For purposes of this section, a failure relating to an information reporting requirement means -

- (1) A failure described under § 301.6721-1(a)(2) relating to the failure to file timely correct information returns as defined in section 6724(d)(1),
- (2) A failure described under § 301.6722-1(a)(2) relating to the failure to furnish timely a correct payee statement as defined in section 6724(d)(2), and
- (3) A failure described under § 301.6723-1(a)(2) relating to the failure to timely comply with and to include correct specified information as defined in section 6724(d)(3).



Statutory Authorities

§ 301.6722-1(a)(2) Failure to file correct information returns.

(a) Imposition of penalty -

(1) General rule. A penalty of \$50 is imposed for each payee statement (as defined in section 6724(d)(2)) with respect to which a failure (as defined in section 6722(a) and paragraph (a)(2) of this section) occurs.

(2) Failures subject to the penalty. The failures to which section 6722(a) and paragraph (a)(1) of this section apply are -

- (i) A failure to furnish a payee statement on or before the prescribed date therefore to the person whom such statement is required to be furnished ("failure to furnish timely"), and
- (ii) A failure to include all of the information required to be shown on a payee statement or the inclusion of incorrect information ("failure to include correct information").



IRC 6724(d)(2):

(d) Definitions (2) Payee statement

- Such term also includes any form, statement or schedule required to be furnished to the recipient of any amount from which tax was required to be deducted and withheld under chapter 3 or 4.
- Chapter 3 – Withholding of Tax on Nonresident aliens and Foreign Corporations)



Application of the Penalty.

The details are in Treasury Regulations 301.6724.

However, for ease of reference and procedural clarification, IRM
20.1.7.1



20.1.7.1 (10-12-2017)

Program Scope and Objectives

- (1) **Purpose:** This IRM provides policy and procedures for the application of information return penalties assessable under IRC 6721, IRC 6722, and IRC 6723. It also discusses reasonable cause criteria per IRC 6724 and 26 CFR 301.6724-1.
- (2) **Audience:** All operating division employees who address information return penalties



Per IRM 20.1.7.12.1 (7):

Reasonable cause for the information return penalties generally exists when:

The filer acted in a responsible manner, both before and after the failure occurred, **and**

(i) There are significant mitigating factors, or (ii) The failure was the result of circumstances beyond the filer's control.



Statutory Authorities

(8) Acting in a Responsible Manner ([26 CFR 301.6724-1\(d\)](#)) generally includes exercising the same degree of care that a reasonably prudent person (or organization) would use in the course of its business in determining filing obligations and in handling account information such as account numbers and balances. The filer must act in a responsible manner both before **and** after the failure occurs. Acting in a responsible manner also includes taking steps to avoid the failure, for example:

Requesting appropriate extensions of time to file when practical to avoid the failure,

Attempting to prevent a failure if it was foreseeable,

Acting to remove an impediment or the cause of the failure, and

Correcting the failure as promptly as possible, generally within 30 days.



Statutory Authorities

(10) When reviewing a filer's request for a waiver, the following questions must be addressed to determine if the filer has acted in a responsible manner:

1. Do the reasons address the penalty that was assessed?
2. Does the length of time between the event cited as a reason and the filing date negate the event's effect?
3. Does the continued operation of a business after the event that caused the filer's noncompliance negate the event's effect?
4. Should the event that caused the filer's noncompliance or increased liability have reasonably been anticipated?
5. Is the penalty the result of carelessness or did the filer appear to have made an honest mistake? Note: Carelessness and forgetfulness are not examples of ordinary business care and prudence.
6. Has the filer provided sufficient detail (dates, relationships) to determine whether they exercised ordinary business care and prudence?
7. Is a non-liable person being blamed for the filer's noncompliance? What is the nature of the relationship between the taxpayer and the individual? Is the individual an employee of the taxpayer or an independent third party, such as an accountant or lawyer?
8. Has the filer documented all pertinent facts, i.e. death certificate, doctor's statement, insurance statement for proof of fire, etc.?
9. Does the filer have a history of being assessed the same penalty?
10. Could the filer have requested an extension or filed an amended return?



Statutory Authorities

(12) Significant mitigating factors - For the filer to establish reasonable cause under this category, the filer must show that they acted in a responsible manner as well as the existence of a significant mitigating factor. Events generally considered to be significant mitigating factors include, but are not limited to:

First time filer - prior to the failure, the filer had not previously been required to file this particular form or statement.

The filer has a history of complying with the information return reporting requirements.

Significant consideration is given to if the filer was previously penalized under IRC 6721, IRC 6722, or IRC 6723.



Statutory Authorities

Circumstances beyond the filer's control:

1. Actions of the IRS

2. Action of an Agent:

The filer exercised reasonable business judgment when contacting the agent, allowing the agent to timely file correct returns, or furnish correct payee statements.



Actions of an Agent (continued)

The filer provided the agent with proper information well in advance of the due date of the return or statement, and

- the agent satisfied the significant mitigating factors,
- or an event beyond the agent's control occurred that could establish reasonable cause.



Statutory Authorities

A filer who contracted with an agent and cannot establish reasonable cause based on the actions of the agent as described above, may be able to demonstrate reasonable cause on his/her own merit by having an established history of complying with the information reporting requirements, and otherwise acting in a responsible manner both before and after the failure occurred.

(Demonstrates that they acted in a responsible manner and they had significant mitigating factors.)



Statutory Authorities

Actions by the payee or any other person --For the filer to establish reasonable cause as the result of actions by the payee or any other person with respect to the return or payee statement, the filer must show that:

The payee, or other person, failed to provide the necessary information to the filer, or

The payee, or other person failed to provide correct information to the filer.

The filer made available to the payee all necessary information to complete the filing

The filer **must provide documentary evidence when requested by the IRS** showing that the failure was attributable to the payee.

See [26 CFR 301.6724-1\(e\) and \(f\)](#), [IRM 20.1.7.12.2.2](#) and [IRM 20.1.7.12.2.4](#) for special solicitation requirements that a filer must follow to establish reasonable cause if the failure of the filer to provide a correct TIN was due to the actions of the payee.



(19) Unavailability of business records

The business records must have been unavailable as a result of unforeseen conditions, and in a manner which would prevent timely compliance (ordinarily at least a two week period prior to the due date or extended due date) of the information return, and the unavailability was caused by a supervening event. # In the case of a corporation, estate, trust, *etc.*, the death, serious illness, or unavoidable absence of a member of the immediate family of the person having sole authority to file the information return may constitute reasonable cause. #

See this IRM 20.1.7.12.1 for additional guidance

McGeehan Russell W

From: Cuello Maricarmen R
Sent: Wednesday, February 2, 2022 12:42 PM
To: McGeehan Russell W
Subject: FW: Quick reminder
Attachments: ACI Memo - OVDP- 2013.pdf

Maricarmen Cuello

Independent Office of Appeals
Director, International - Area 11
51 S.W. 1st Avenue, Suite 723
Miami, FL 33130

(b)(6); (b)(7)(E)

From: Cuello Maricarmen R
Sent: Tuesday, November 23, 2021 5:08 PM
To: &AP-SEPR-11 Employees (b)(7)(E)
Cc: Cuello Maricarmen R (b)(6); (b)(7)(E)
Subject: Quick reminder

Good afternoon,

Just wanted to remind everyone that any case related to an OVDI or OVDP opt out case requires R & C from the appropriate coordinator as indicated by the attached memo. I recently canvassed the teams and it appears we currently have several cases in inventory related to OVDI or OVDP opt out cases. We want to ensure continued consistency in the settlement of these cases. Please let me know if you have any concerns.

Thanks,

Maricarmen Cuello

Independent Office of Appeals
Director, International - Area 11
51 S.W. 1st Avenue, Suite 723
Miami, FL 33130

(b)(6); (b)(7)(E)



FATCA/Form 8938

- Learning Objectives
 - 1) Have an increased understanding of the Form 8938 filing requirements
 - 2) Have an increased understanding of the reasonable cause exception for late filing of Form 8938
 - 3) Have an increased understanding of the information available on the Appeals Issue Locator for this issue
 - 4) Understand your responsibilities under IRM 8.11.5 for this issue

This is our second presentation in a series focused on sharing information and practices to improve our work quality and practices. Last month addressed penalty appeals. Today we are focused on our work centered around claim cases both administrative and technical.

- Penalties
 - Exception for reasonable cause
 - No caselaw to date
 - Ignorance of the law
 - Information about F8938 has been provided in 1040 schedules, forms and instructions since tax year 2011, as well as numerous tax preparation software programs
 - Reliance on advice from a tax professional
 - Neonatology case could apply, reasonable cause accuracy penalty case
 - Mentioned in *Flume v. Com'r*, TC Memo 2017-21, 5471 penalty case
 - 1. Competent professional with sufficient expertise
 - 2. TP provided necessary and accurate information to the tax advisor
 - 3. TP relied in good faith on the tax professional's tax advice

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- Appeals Issue Locator
 - <https://organization.ds.irsnet.gov/sites/APPEALS-PQCS/SitePages/IssueLocator.aspx>
 - Demo
 - Appeals Coordinated Issue, Review/Concurrence required
 - [ACI Memorandum - FATCA IRC 6038D- ACI RC.docx.pdf](#)
 - AI Feature Code & submit Form 13881 in ACDS
 - Current coordinators – (b)(6)
 - Management determines which coordinator assigned, with coordinator input
 - Related cases is relevant
 - If there is a Form 8938 penalty case and a related FBAR penalty case, (b)(6) is the preferred coordinator for both related cases
 - If there is a Form 8938 penalty case and a related foreign trust penalty case, (b)(6) is the preferred coordinator for both.

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- IRM 8.11.5 International Penalties
 - IRM 8.11.5.13 FATCA/Form 8938
 - Post assessed, pre-payment penalty appeal rights
 - Handle procedurally as a PENAP case
 - Must verify that the penalties were assessed before case can be worked by Appeals
 - Individual (other than MFJ) cases – MFT 55; Individual (MFJ) case – MFT 30
 - Business – MFT 13
 - Transaction code 240 IDRS; Penalty Reference Number (PRN) 700 Initial penalty or 710 for continuation penalties
 - Penalty amounts must match that on Exam manager approved Form 8278
 - Close case as premature referral if penalties aren't assessed

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Internal Revenue Service
MEMORANDUM

date: March 26, 2021

to: Maricarmen Cuello, Director of International

from: (b)(6) Appeals Team Manager, Team 3

subject: Form 3520-A Penalty Administrative Relief

A foreign trust with at least one U.S. owner must file a Form 3520-A annually to provide information about the trust, its U.S. beneficiaries and any U.S. person who is treated as an owner of any portion of the foreign trust. The U.S. owner is subject to an initial penalty equal to the greater of \$10,000 or 5% of the gross value of the portion of the trust's assets treated as owned by the U.S. person at the close of that tax year if the foreign trust (a) fails to file a timely Form 3520-A, or (b) does not furnish all of the information required by section 6048(b) or includes incorrect information.

If a foreign trust fails to file a Form 3520-A, the U.S. owner must complete and attach a substitute Form 3520-A to the U.S. owner's Form 3520 by the due date of the U.S. owner's Form 3520 (and not the due date for Form 3520-A) in order to avoid being subject to a penalty for the foreign trust's failure to file a Form 3520-A. For example, a substitute Form 3520-A that, to the best of the U.S. owner's ability, is completed and attached to the U.S. owner's Form 3520 by the due date for the Form 3520 (such as April 15 for the U.S. owners who are individuals) is considered timely filed.

Recently, we have been faced with the question whether or not attaching a Foreign Grantor Trust Owner Statement from the Form 3520-A to a timely filed and properly completed Form 3520, would meet the requirements for late filing of Form 3520-A penalty relief under IRM 20.1.9.14.1(3) and IRM 21.8.2.19.3. These IRM sections grant late filing of Form 3520-A penalty relief to trust owners when the Form 3520-A is late filed, but the trust owner timely files and accurately completes Part II of Form 3520, and attaches a "substitute Form 3520-A" to their Form 3520.

Form 3520 Part II asks the Taxpayer whether a Form 3520-A was filed for the foreign trust. If the Taxpayer answers "yes", then they are instructed to attach a copy of the Foreign Grantor Trust Owner Statement to the Form 3520. If the Taxpayer answers "no", then they are instructed to attach a "substitute 3520-A" completed to the best of their ability to their Form 3520.

To qualify for penalty relief under these IRM provisions, the following must occur:

1. The Form 3520 must be filed before the Form 3520-A. AO's can check IDRS and/or AMS for filing dates. The Taxpayer must answer the question on Form

3520 Part II as “no”, indicating Form 3520-A had not yet been filed at the time the Form 3520 was filed.

2. If the Form 3520 is filed before the Form 3520-A and the Form 3520 Part II question was answered “no” as stated in #1, either a complete copy of a completed “draft” Form 3520-A must be attached to Form 3520, or a “substitute 3520-A”. If a complete copy of the “draft” Form 3520-A is attached, then penalty relief should be granted as a complete copy of a “draft” would equate to a “substitute 3520-A”. The “substitute 3520-A” is the Taxpayer’s best attempt at completing the Form 3520-A and is less accurate than the “draft”. Facts and circumstances come into play here. If the 3520-A can be completed before the due date of Form 3520 (including extensions), then the Taxpayer can attach a complete “draft” copy of the Form 3520-A to the Form 3520. However, if the 3520-A is not able to be completed before the due dates of Form 3520 (including extensions), then the Taxpayer’s “substitute 3520-A” can simply be an estimate of Form 3520-A, based on best available information at the time.

Changes were made to the year 2020 IRS Forms 3520 and 3520-A, as well as their instructions, to address the requirements more clearly for penalty relief under these IRM provisions.

If the Taxpayer fails to meet the requirements for penalty relief under these IRM provisions, reasonable cause should still be considered. Even though attaching the Foreign Grantor Trust Owner statement from Form 3520-A to the timely filed and properly completed Form 3520 doesn’t meet the IRM provisions for relief for 3520-A late filing penalties, it may be a strong favorable reasonable cause factor. Other positive and negative reasonable cause factors should be considered and weighed as well, including, but not limited to the following:

1. Was the income from the Foreign Grantor Trust Owner Statement properly and timely reported on the taxpayer’s income tax return (i.e. Form 1040)?
2. Did the Taxpayer file Schedule B with Form 1040, and if so, did the Taxpayer answer the question regarding ownership of a foreign trust as “yes”?
3. Prior compliance history
4. Subsequent compliance history
5. Reason(s) for late filing of Form 3520-A
6. How late was Form 3520-A?
7. How long did it take the trust to file Form 3520-A once it realized it was late?

(b)(6)	(b)(7)(E)
(b)(7)(E)	

From: Harris Margaret K on behalf of (b)(6)
To: Harris Margaret K; (b)(6)
Cc: (b)(6) &AP-SEPR-11 Appeals Officers; &AP-SEPR-11 Team Managers; (b)(6) Cozzarelli Robert; (b)(6)
Subject: FW: Various workshops - 1) Certain Foreign Statutes, 2) F8938 Penalties, and 3) Foreign gift/inheritance penalties
Attachments: [ACI Memorandum - FATCA IRC 6038D- ACI RC.docx.pdf](#)
[certain foreign statutes.pptx](#)
(b)(3):26 U.S.C. § 6103
[F8938 workshop.pptx](#)
[Foreign gift and inheritance penalty workshop.pptx](#)
(b)(3):26 U.S.C. § 6103

-----Original Appointment-----

From: (b)(6)
Sent: Monday, July 20, 2020 7:23 PM
To: (b)(6)
Cc: (b)(6) &AP-SEPR-11 Appeals Officers; &AP-SEPR-11 Team Managers; Harris Margaret K; (b)(6) Cozzarelli Robert; (b)(6)
Subject: Various workshops - 1) Certain Foreign Statutes, 2) F8938 Penalties, and 3) Foreign gift/inheritance penalties
When: Thursday, July 23, 2020 10:00 AM-1:30 PM (UTC-08:00) Pacific Time (US & Canada).
Where: Skype Meeting for Video, Call-in for Audio

Hi everyone,

This is a workshop for the new hires from earlier this year. Those are listed as required attendees. Everyone else listed is optional. I'm the coordinator for the foreign gift/inheritance penalty issue, and co-coordinator for the F8938 penalty issue. The foreign gift/inheritance presentation has not previously been provided for new hire training, so I welcome anyone to attend. The F8938 penalty workshop and certain foreign statute workshop were previously provided to the Fall 2019 new hires, and are basically a repeat (no new information/updates added).

I tried to include everyone I know that might be interested in the invite, who's in Appeals. If I missed anyone, please feel free to forward to them

For those of you who cannot attend, I've attached my power point presentations (and other attachments) that I will be using during the presentations.

Looking forward to a good discussion tomorrow. We will break for 30 minutes at some point for lunch. The presentation will be no longer than 3 hours.

Call in for audio, Skype for power point presentation (video). Call in (b)(7)(E) Please mute your Skype microphones.

Join Skype Meeting <(b)(6); (b)(7)(E)>

Trouble Joining? Try Skype Web App <(b)(6); (b)(7)(F)>

Help <<https://o15.officeredir.microsoft.com/r/rlidLync15?clid=1033&p1=5&p2=2009>>

[!OC({1033})!]



Foreign trust penalties

- Appeals coordinated issue, requiring review and concurrence
 - Primary – (b)(6)
 - Secondary – (b)(6)
 - Provide coordinator with copies of Gov't position and protest with ACM
- Issue Locator
 - <https://organization.ds.irsnet.gov/sites/APPEALS-PQCS/SitePages/IssueLocator.aspx#InplviewHash4b0a038c-8991-4b60-a212-03603dacd538>
- Form 13881 referral required
 - Provide information about related Appeals cases in referral
 - Submit in ACDS prior to submitting case to coordinator for R&C

This is our second presentation in a series focused on sharing information and practices to improve our work quality and practices. Last month addressed penalty appeals. Today we are focused on our work centered around claim cases both administrative and technical.



Foreign trust penalties

- Source of cases
 - Campus
 - Gov't position on 854c letter
 - Penalties assessed upon processing of late filed Form 3520 or Form 3520-A
 - Protest in response of 854c letter
 - Field
 - Gov't position on leadsheet and/or Form 886-A, provided with 30-day letter
 - Penalties assessed during Exam case closure via Form 8278
 - Penalty amounts assessed should match Form 8278
 - Protest in response of 30-day letter

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- IRM 8.11.5 International Penalties
 - IRM 8.11.5.8 Form 3520 (foreign trust) penalties
 - IRM 8.11.5.9 Form 3520-A penalties
 - Filed with Ogden Service Center
 - Post-assessed, pre-payment appeal rights
 - If penalties not assessed before case gets to Appeals, release jurisdiction to Compliance as premature referral
 - Penalties for late or incomplete filing
 - Assessed on MFT 13 (Business) or 55 (Individual), TC 240
 - Unique 3 digit PRN
 - <http://serp.enterprise.irs.gov/databases/irm.dr/current/e6209/civil-penalty-reference-numbers.html?code=677&theRow=131>
 - Reasonable cause exception
 - Worked as PENAP cases (see IRM 8.11.4)

This is our second presentation in a series focused on sharing information and practices to improve our work quality and practices. Last month addressed penalty appeals. Today we are focused on our work centered around claim cases both administrative and technical.

- Common Disputed Issues in Appeals
 - Reasonable cause IRC Section 6677(d)
 - Depends on facts and circumstances of each case
 - No case law directly on point
 - No 3520 or 3520-A reasonable cause court decisions
 - Common arguments for initial penalties
 - Ignorance of the law
 - Form 1040, Schedule B, and their instructions contain references to both Form 3520 and 3520-A regarding foreign trusts
 - Reliance upon advice of a tax professional
 - *Neonatology Associates, P.A. v. Commissioner*, 115 TC 43 98-99 (2000), aff'd 299 F.3d 221 (3d Cir. 2002)
 - This case cited on a Form 5471 reasonable cause case, where the argument was reliance on advice of a tax professional for late filing
 - *Edward S. Flume v. Commissioner*, TC Memo 2017-21

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- *Neonatology Associates, P.A. v. Commissioner*, 115 TC 43 98-99 (2000), aff'd 299 F.3d 221 (3d Cir. 2002)
 - It is a 3-prong test, with all 3 parts needing to be satisfied.
 - #1 – a competent professional with sufficient expertise was consulted
 - #2 – taxpayer provided the advisor with accurate and complete information
 - #3 – Taxpayer reasonably relied in good faith on the advice provided
- Exam will accept reliance on the advice of a tax professional as reasonable cause if they believe the requirements of *Neonatology* were met.

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- Common reasonable cause arguments for continuation penalties
 - Unable to obtain information in time
 - See IRM 20.1.1.3.2.2.3 and case law for general reasonable cause guidance
 - Death, serious illness, or unavoidable absence
 - See IRM 20.1.1.3.2.2.1 and case law for general reasonable cause guidance
 - No case law for international information return continuation penalties
 - Facts and circumstances issue
- No filing requirement
 - Entity is not a trust, it's something other than a trust (maybe a business)
 - *Estate of Swan v. Commissioner*, 24 TC 829 (1955) affirmed in part and reversed in part on other grounds, 1247 F.2d 144 (2d Cir. 1957)
 - The Tax Court concluded that Liechtenstein Stiftungen were comparable to trusts for U.S. estate tax purposes, rather than corporations. Classification of a particular Stiftung must depend on the nature of activities carried on by the entity

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Foreign trust penalties

- Appeals coordinated issue, requiring review and concurrence
 - Primary – (b)(6)
 - Secondary – (b)(6)
 - Provide coordinator with copies of Gov't position and protest with ACM
 - Per IRM, Coordinator can waive requirement to provide Gov't position and/or protest (case by case basis during COVID)
- Issue Locator
 - <https://organization.ds.irsnet.gov/sites/APPEALS-PQCS/SitePages/IssueLocator.aspx#InplviewHash4b0a038c-8991-4b60-a212-03603dacd538=>

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 - Reasonable cause IRC Section 6677(d)
 - Depends on facts and circumstances of each case
 - No case law directly on point
 - No 3520 or 3520-A reasonable cause court decisions
 - Common arguments for initial penalties
 - Ignorance of the law
 - Form 1040, Schedule B, and their instructions contain references to both Form 3520 and 3520-A regarding foreign trusts
 - Didn't realize it could be a trust (i.e. Canadian TFSA, Canadian RESP, foreign pension, etc.)
 - Reliance upon advice of a tax professional
 - *Neonatology Associates, P.A. v. Commissioner*, 115 TC 43 98-99 (2000), aff'd 299 F.3d 221 (3d Cir. 2002)
 - *James v. U.S.* [110 AFTR 2d 2012-5587 (M.D. Florida, 2013)]

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- Neonatology
 - It is a 3-prong test, with all 3 parts needing to be satisfied.
 - #1 – a competent professional with sufficient expertise was consulted
 - #2 – taxpayer provided the advisor with accurate and complete information
 - #3 – Taxpayer reasonably relied in good faith on the advice provide
 - This case cited on a Form 5471 reasonable cause case, where the argument was reliance on advice of a tax professional for late filing
 - *Edward S. Flume v. Commissioner*, TC Memo 2017-21
- James
 - Addressed the 3rd test in Neonatology above
 - Court said it was POSSIBLE that preparer checking "No" to Schedule B question (did you receive a distribution from or were you the grantor of, or transferor to, a foreign trust?) could be construed as advice of not having to file Form 3520.

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Foreign trust penalties

- Campus cases – multiple delinquent 3520 and 3520-A filings at same time (i.e. multiple tax years and/or multiple filings for multiple trusts)
 - Issue #1 – Penalties for some years, but not all years
 - Example – TP filed delinquent 3520's for his Canadian RESP for years 2012-2016, all on 2/1/18. TP assessed late filing penalties for 2012 and 2013, but not for 2014-2016. POA argues that 2014-16 were not penalized, so IRS shouldn't penalize 2012-2013 either.
 - Issue #2 – Some trusts penalized, some not penalized
 - Example – TP filed delinquent 3520-A's for his Canadian RESP and Canadian TFSA for year 2017 on 2/1/2020. Same facts and circumstances for late filing for both the RESP and TFSA. TP received a late filing F3520-A penalty notice for \$10,000, with no explanation whether or not the penalty pertains to the RESP or TFSA. POA argues that the penalty should be fully conceded because the Service failed to even indicate what trust (TFSA or RESP) the penalty relates to.

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IRC SECTION 6038A

Small Corporation Exception

6038A REQUIREMENTS

- Domestic Corporation (“Reporting Corporation”). 6038A(a)(1).
- 25% Foreign Owned Directly or Indirectly By 1 Foreign Person (Related Party). 6038A(c)(1).
- Reportable Transaction Between Parties. 6038A(b).
- If requirements are met, Form 5472 is required to be filed.

May want to cover indirect ownership since most of the people in teams 3,4,5 haven't had that training. \

FILING REQUIREMENT

- Form 5472 must be filed with the reporting corporation's income tax return for the taxable year by the due date (including extensions) of that return. 1.6038A-2(d).
- Prior to 2014, a Form 5472 had to be filed separately if the corporation was not timely filing its tax return.

6038C REQUIREMENTS

- The foreign corporation is the “Reporting Corporation”. 6038C(a).
- Since 6038A and 6038C use the same Regulations, must determine who is the “Reporting Corporation”.

PENALTIES

- \$10,000 penalty for late filed or incomplete 5472. 6038A(d)(1).
- Continuation penalty. Increase in penalty where failure continues after notification. 90 days after notification, \$10,000 continuation penalty for each 30 day period. 6038A(d)(2).
- Service Center has systematically assessed penalty on late filed 1120's with 5472 included starting in 2013. IRM 21.8.2.22.2.

PENALTIES

- Section 6038A penalties can be assessed without statutory notice of deficiency procedures. When you receive a case, the penalty should already be assessed. Assessed under MFT 13 for corporations.
- For 1120's, BMFOLR for MFT 02 will tell you how many 5472's were filed with the tax return.

Beginning in what year?

COURT JURISDICTION

- Since assessments will have been made, taxpayers will not be able to go to Tax Court. US District Court or US Court of Claims will be venue. *Wheaton V. United States*, 79AFTR 2d 97-1865. US District Court, New Jersey. June 13, 1995. (6038 penalty; should apply to 6038A.)
- But, taxpayers can “backdoor” into Tax Court through CDP if not previously in Appeals. *Flume v. Commissioner*, TC Memo 2017-21.

SMALL CORPORATION

- 1.6038A-4(b)(2)(ii) Small corporations. The District Director shall apply the reasonable cause exception liberally in the case of a small corporation that had no knowledge of the requirements imposed by section 6038A; has limited presence in and contact with the United States; (continued on next page)

SMALL CORPORATION

- 1.6038A-4(b)(2)(ii) continued...
- ...and promptly and fully complies with all requests by the District Director to file Form 5472, and to furnish books, records, or other materials relevant to the reportable transaction. A small corporation is a corporation whose gross receipts for a taxable year are \$20,000,000 or less.

SMALL CORPORATION

Four Requirements

Requirement #1: Gross receipts for a taxable year are \$20,000,000 or less.

- 1.6038A-(4)(b)(2) refers to the “reporting corporation”. The reporting corporation is to be used to determine whether or not a small corporation. 6038A: domestic corporation. 6038C: foreign corporation.

SMALL CORPORATION

Four Requirements

Requirement #2 – No knowledge of the requirement to file 5472 and / or maintain records.

- Doesn't apply if they filed Form 5472 previously since this demonstrates knowledge.
- This regulation must be reconciled with the standard in IRM 20.1.1.3.2.2.6 which states in general that the taxpayer must make reasonable efforts to determine tax obligations.
- Is the taxpayer a sophisticated multinational corporation in another country?
- Should a shareholder in Canada, a neighboring country have a higher standard for knowledge than someone from India, for instance?

SMALL CORPORATION

Four Requirements

Requirement #3: Reporting corporation has limited presence in and contact with United States.

- Look at the facts of each case. What is the taxpayer's business? Is the US corporation fully foreign owned or are there US shareholders? How many US employees? How big is the corporation/what is the dollar value of assets owned?

SMALL CORPORATION

Four Requirements

Requirement #3. Reporting corporation has limited presence in and contact with United States.

- Limited presence is a matter of judgment. With respect to foreign individuals or foreign corporations that own US rental property, this would be limited presence as it is a passive type activity with few employees.

SMALL CORPORATION

Four Requirements

Requirement #4: Reporting corporation complies with requests to furnish records.

- This aspect may not be applicable if the taxpayer discovered and corrected their delinquency on their own initiative. However, it would be applicable to the extent that the government asks for information relevant to the Form 5472 filing.

What is our responsibility to consider the Small Corporation Exception?

- Questions:
 - Isn't it the taxpayer's responsibility to make an affirmative showing of reasonable cause?
 - Am I violating AJAC or developing the taxpayer's position if I take proactive consideration of this regulation on behalf of the taxpayer?

Small Corporation Exception – Taxpayer's responsibility?

- 20.1.1.3.2
- (11-25-2011)

- **Reasonable Cause**

(2) In the interest of equitable treatment of the taxpayer and effective tax administration, the non-assertion or abatement of civil penalties based on reasonable cause or other relief provisions provided in this IRM must be made in a **consistent** manner and should **conform** with the considerations specified in the IRC, Treasury **Regulations** (Treas. Regs.), policy statements, and IRM Part 20.1, *Penalty Handbook*. (Emphasis added)

Since this provision is in the regulation, for consistency and equity, we need to determine whether it applies.

Small Corporation Exception – Taxpayer’s responsibility?

- In order to provide equitable and consistent treatment to each taxpayer, we should advise them of the small corporation exception regulation if they are not aware of it and provide them a written or verbal opportunity to discuss how it may apply.
- Technically, we cannot request specific documents or “develop the taxpayer’s position” per IRM 8.11.4.1.6.
- We should review the underlying tax returns which are the basis of the penalty which are the Forms 1120 and Forms 5472. May need to get these from the taxpayer if they are not available on IRS transcripts.

The actual tax returns are going to provide us information that will be helpful in assessing whether the small corporation exception applies.

How Does AJAC impact our consideration of the Small Corporation Exception?

- What are the AJAC restrictions?

The IRM provides a lot of authority for Appeals to review information and not be in violation of AJAC with respect to penalty appeals. Many documents provided are corroborating evidence and don't meet the definition of new information. For documents that do meet that definition, there is an AJAC waiver under IRM 8.6.5.1.6.5.2 for reviewing new information relative to campus sourced penalties - \$10,000 per tax period.

How Does AJAC impact our consideration of the Small Corporation Exception?

- IRM 8.11.4.1.6(10)
- Many documents received during a PENAP consideration may not meet the definition of “new information”. Many penalties are assessed without deficiency procedures and reasonable cause needs to be established for the abatement of these penalties. Documents received during a PENAP consideration are generally not voluminous or require additional development, and in many instances, are corroborating the taxpayer’s testimony. You should consider the probative value of any evidence that does not meet the definition of “new information” above and apply hazards of litigation in making a determination.

How Does AJAC impact our consideration of the Small Corporation Exception?

- IRM 8.6.5.1.6.5.2: (Exception made for New Information)

If the case is IRS Campus-sourced (including claims, PENAPs, International penalties, and International Individual Compliance (IIC) - Tax Examiner cases as identified on Form 3198), determine if it meets the exception after receiving all new information. If the case meets the exception, review the new information and proceed with normal consideration. If the case does not meet the exception, go on to paragraph (3).

Exception: Threshold for IRS Campus sourced cases: Do not return the case to the originating IRS Campus function if it is possible to review and determine the probative value of the new information in no more than 4 hours and the tax liability (or aggregate penalty amount in a penalty appeals case) attributable to the new information or issue is less than \$5,000 per tax period. For International Penalties under IRC 6038 and 6038A on Forms 5471 and 5472, the threshold increases to penalties less than or equal to \$10,000 per tax period. Review all new information before determining whether this exception applies. **Note:** Add Feature Code "NI" (New Information) to Campus-sourced cases where the taxpayer provides new information and the case meets the exception in (2) and Appeals will retain jurisdiction.

What is our responsibility to consider the Small Corporation Exception?

Summary:

These penalty appeal cases have not had extensive Exam consideration at the Campus and the IRM is granting us justification and liberty to review additional documents and new information.

Note that the Campus does not consider the small business exception so returning the case would not be effective.

Applying the Reasonable Cause Exception Liberally under Treas. Reg. 1.6038A-4(b)(2)(ii) – Example

Example :

A taxpayer from Bolivia formed a US corporation and invested in a small real estate rental in Southern Florida. Although the taxpayer engaged a US attorney to assist him in the acquisition and the formation of the corporation, the attorney did not provide any advice on US tax filing requirements. Since the corporation reported losses, the taxpayer was not concerned about a lack of US tax filing since he considered that there was no harm to the US government if no tax were due. After having discussion with others, he learned about the requirements for filing and the Forms 5472. He engaged a CPA to prepare the delinquent returns and Forms 5472. He was surprised when he received a notice of a \$10,000 delinquency penalty for each year of failing to timely file the Form 5472. The taxpayer/CPA claimed a liberal application of the reasonable cause exception due to the taxpayer's lack of knowledge and prompt filing once he learned of the filing requirements. Does the taxpayer qualify for reasonable cause under this Treasury regulation?

Applying the Reasonable Cause Exception Liberally under Treas. Reg. 1.6038A-4(b)(2)(ii) – Example

Answer:

Yes, the taxpayer qualifies for the liberal application of the reasonable cause exception under 1.6038A-4(b)(2)(ii) because he meets all the requirements under this regulation.

1. Small corporation of gross receipts of \$20 million or less. Yes. The taxpayer is a small corporation as verified on the Form 1120 tax returns/transcripts.

2. Taxpayer had no knowledge of the requirement to file:

The taxpayer's claim that he had no knowledge of the requisite US tax laws is supportable based on his lack of filing and in view of the fact that he is a limited, unsophisticated investor and located in another continent (South America).

3. The taxpayer has a limited US presence. Yes. His US corporation has limited rental activity, has no employees and therefore has a limited US presence.

4. The taxpayer complied with all requests by the Commissioner to furnish information. This is not applicable since the taxpayer identified his own noncompliance and self-reported.

REASONABLE CAUSE

- IRM 20.1.1.3.2: Reasonable Cause.
- (1) Reasonable cause is based on all facts and circumstances in each situation and allows the IRS to provide relief from a penalty that would otherwise be assessed. Reasonable cause relief is generally granted when the taxpayer exercised ordinary business care and prudence in determining his or her tax obligations but nevertheless failed to comply with those obligations.

REASONABLE CAUSE

- Regulations 1.6038A-4(b).
- The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. 1.6038A-4(b)(2)(iii).

UNITED STATES V. BOYLE

- Supreme Court. 105 S.Ct. 687.
- Decided January 9, 1985. Estate tax case.
- Supreme Court overturned lower courts and determined reliance on someone to file is not reasonable cause.
- “The failure to make a timely filing of a tax return is not excused by the taxpayer’s reliance on an agent, and such reliance is not “reasonable cause” for a late filing under 6651(a)(1).”

UNITED STATES V. BOYLE

- “This case is not one in which a taxpayer has relied on the erroneous advice of counsel concerning a question of law. Courts have frequently held that “reasonable cause” is established when a taxpayer shows that he reasonably relied on the advice of an accountant or attorney that it was unnecessary to file a return, even when such advice turned out to have been mistaken...

UNITED STATES V. BOYLE

- “...This court also has implied that, in such a situation, reliance on the opinion of a tax advisor may constitute reasonable cause for failure to file a return.”
- “When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advise.”

UNITED STATES V. BOYLE

- “By contrast, one does not have to be a tax expert to know that tax returns have fixed filing dates and that taxes must be paid when they are due.”
- The Court is saying that meeting a filing deadline is not something that can be delegated. Courts also interpret this to also mean requesting an extension to file is also not something that can be delegated.

Let's look up these court cases.

OTHER CASES V. BOYLE

- *Estate of Thouron v. United States.*
- U.S. Court of Appeals Third Circuit.
- 752 F.3d 311. 2014.
- Analyzed Boyle to have three distinct categories of late-filing cases
- Reliance to file timely; files within time advised by attorney; attorney advises on a matter of tax law. Boyle only addressed reliance to file timely.

OTHER CASES V. BOYLE

- *Estate of Esther M. Hake v. U. S.*
- U.S. District Court, M.D. Pennsylvania.
- 119 AFTR 2d 2017-727. February 10, 2017.
- Court sided with taxpayer on late penalty due to reliance on attorney saying there was a one year extension when there was only a six month extension.

OTHER CASES V. BOYLE

- *Estate of Hake*.
- “Upon consideration of the parties’ briefs, the unique and undisputed facts of this case, as well as the developing law in this field, the Court finds that the executors’ reliance upon the advice of their counsel in these particular circumstances regarding the applicable deadlines for filing the estate’s return was reasonable, and, therefore, the imposition of the penalties and interest was not warranted.”

Penalty Abatement for 5471 and 5472 based on reasonable
cause

Range of Appeals Determinations:

1. Full abatement – taxpayer demonstrated reasonable cause.
2. Full denial – taxpayer did not demonstrate reasonable cause.
3. Partial abatement:
 - a. Based on hazards
 - b. Based on mitigation factors and penalty policy.

Partial Penalty Abatement Based on a Hazard Assessment

Factual Hazard Assessment: Used when the salient facts are unclear as to whether the taxpayer meets reasonable cause.

Examples:

- A taxpayer claims he was ill at the time a return was due but the facts are inconclusive.
- The taxpayer filed a return 10 days late and the facts are inconclusive regarding whether he timely postmarked his filing.
- These are examples of where we would make a hazard assessment. If the taxpayer prevailed at court in proving their facts, they would meet reasonable cause. Since the facts are inconclusive, then a hazard assessment is necessary.

When Would Mitigation Apply?

Mitigation applies when there are minimal or no hazards but extenuating circumstances exist. Mitigation is available but should be used sparingly.

A recent, Appeals Penap Study revealed that appeals officers were consistently applying hazards of litigation (HOL) to cases where there were technically no hazards because Boyle and other supporting tax court cases would sustain the government.

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

Example:

The taxpayer relied on a CPA tax preparer to file his tax return extension. Due to a software glitch and some oversight of the employee, the electronic extension form was not received by the IRS. The taxpayer was not aware of this problem. In fact, they received correspondence from the CPA firm which assured them that the appropriate extension had been filed. Ultimately, the taxpayer was assessed \$200,000 for 20 delinquent Forms 5472. The taxpayer has never been delinquent in filing returns or extensions in the past. Further, the delinquent return was filed within the extension period. However, the taxpayer was not granted first time abatement from the AMS Campus review. You reviewed transcripts to verify the good filing history and the letter of confirmation received by the taxpayer from the CPA firm. How should Appeals resolve this case? Technically, there are no hazards involved because of Boyle, other Tax Court cases and a recent Counsel memo that support the conclusion that the taxpayer cannot rely on others to ministerial file their tax returns or file extensions.

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

- The typical ACM in the Penap Study would list all of the good faith efforts of the taxpayer such as there is no history of prior penalties, the taxpayer received written assurances from the CPA firm that the extension was filed and the actual return was filed within the extension period and recommend a hazard determination. Technically, there are no hazards in these types of cases and such a decision could be subject to criticism by AQMS, TIGTA, etc. If the appeals officer wants to recommend an abatement of some of the penalty, it would be more appropriate to recommend an abatement on mitigation since no hazards exist.

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

- A more accurate approach would be to “mitigate” the penalty based on positive factors and penalty policy.
- ELMS #63679, Appeals Case Memo on Penalty Appeals Cases, demonstrates the utilization of this approach in a similar case in Scenario 2.
- Mitigation is a concept affirmatively applied with respect to Code Section 6724(d) penalties.

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

What is Mitigation?

- The action of reducing the severity, seriousness, or painfulness of something.
- Mitigation in appeals, therefore, would be reducing the penalty assessed – not based on hazards but based on penalty policy.
- HOWEVER, the extent of mitigation is dependent upon extenuating circumstances. For instance, a taxpayer may have a minor delinquency circumstance but the penalties associated may be hundreds of thousands of dollars. Technically, Boyle and Counsel memos support a full sustention of the penalty. But utilizing mitigation and applying the taxpayer's favorable factors which demonstrate ordinary business care and prudence, we can reduce the penalty based on penalty policy.

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

What is Penalty Policy?

20.1.1.2.1
(11-25-2011)

Encouraging Voluntary Compliance

(1) Taxpayers in the United States assess their tax liabilities against themselves and pay them voluntarily. This system of self-assessment and payment is based on the principle of voluntary compliance. Voluntary compliance exists when taxpayers conform to the law without compulsion or threat.

(2) Compliant self-assessment requires a taxpayer to know the rules for filing returns and paying taxes. The IRS is responsible for providing information to taxpayers, which includes the following:

- Written materials that clearly explain the rules, and
- Forms that permit the self-computation of tax liability.

(3) In addition to (2) above, the IRS must also provide a means to preserve and enhance our voluntary compliance by fairly, consistently, and accurately administering a system of penalties.

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

(4) Although penalties support and encourage voluntary compliance, they also serve to bring additional revenues into the Treasury and indirectly fund enforcement costs. However, these results are not reasons for creating or imposing penalties.

(5) Penalties advance the mission of the IRS when they encourage voluntary compliance. The IRS has formalized this obligation to the public in its mission statement.

(6) **Voluntary compliance is achieved when a taxpayer makes a good faith effort to meet the tax obligations defined by the Internal Revenue Code.**

(7) Penalties support voluntary compliance by assuring compliant taxpayers that tax offenders are identified and penalized.

(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.

Penalty policy is not encouraging voluntary compliance when tax professionals are reconsidering whether they should advise their clients to file delinquent returns when it will result in what they believe to be excessively large penalties.

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

(9) IRS personnel may educate taxpayers and encourage their future compliance by doing the following:

- a. Discussing causes for the delinquency and listening to taxpayers' reasons and concerns for noncompliance,
- b. Ensuring that taxpayers understand their filing and paying responsibilities, and
- c. Being alert to information received in discussions with taxpayers that indicate possible reasons for abatement of a penalty.

(10) Penalties should relate to the standards of behavior they encourage. Penalties best aid voluntary compliance if they support belief in the fairness and effectiveness of the tax system. This belief encourages compliance in areas that cannot be reached through audits or other programs. The IRS's approach to penalties is embodied in Penalty Policy Statement 20-1. See IRM 1.2.20.1.1,

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

- 1.2.20.1.1
(06-29-2004)

Policy Statement 20-1 (Formerly P-1-18)

(1) Penalties are used to enhance voluntary compliance

(2) The Internal Revenue Service has a responsibility to collect the proper amount of tax revenue in the most efficient manner. Penalties provide the Service with an important tool to achieve that goal because they enhance voluntary compliance by taxpayers. In order to make the most efficient use of penalties, the Service will design, administer, and evaluate penalty programs based on how those programs can most efficiently encourage voluntary compliance.

(3) Penalties encourage voluntary compliance by:

1. demonstrating the fairness of the tax system to compliant taxpayers; and
2. increasing the cost of noncompliance.

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

What is our authority for practicing penalty mitigation?

1. We are the only function with delegated authority for resolving tax disputes. IRM 1.2.17.2(3)

IRM 20.1.1.2.1 states that 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.**

2. There is a need to ensure fair and effective policy because these 5471 and 5472 penalties are imposed automatically by an IRS computer program and generally undergo only a decision tree consideration at the Campus. Since they are imposed automatically by a computer, a penalty for the same offense on different taxpayers could range from \$10,000 to \$100,000, for example.

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

IRM 20.1.1.1.3

All functions in the IRS are responsible for proper penalty administration:

“Every function in the IRS has a role in proper penalty administration. It is essential that each function conduct its operations with an emphasis on promoting voluntary compliance. Appropriate business reviews should be conducted to ensure consistency with the penalty policy statement and philosophy.”

With respect to these automatic penalties, there is no prior function that has exercised any independent judgment or assessment made with respect to the applied penalties (unlike field cases such as FBAR where the dollar amount of penalty is carefully considered and for which the IRM provides Exam only the function of mitigation). As a result, it is appropriate for Appeals to incorporate penalty policy in resolutions to ensure that the proposed penalty enhances voluntary compliance and is in accordance with the IRM.

Some Mitigation Guidelines

- Mitigation is sometimes used when the taxpayer does not meet the reasonable cause factors.
- Mitigation generally means reducing a penalty and not reducing it to zero.
- The basis for any mitigation provided should be discussed in great detail in the ACM; there should be a discussion of a multitude of factors which support mitigation. It is generally a good idea to discuss mitigation with the ATM prior to recommending a settlement with the taxpayer.
- If the taxpayer has been delinquent in the past, then this negatively impacts penalty relief. In many cases, full sustention would be appropriate.
- Aside from good faith taxpayer factors, mitigation may be influenced by the size of the company, whether the company is still in business, whether they are reporting losses, whether they are filing delinquent returns primarily for self-motivated interests (tax savings), the type of information omitted, etc.

This is not a tool to give the house away!

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

Example:

The taxpayer relied on a CPA tax preparer to file his tax return extension. Due to a software glitch and some oversight of the employee, the electronic extension form was not received by the IRS. The taxpayer was not aware of this problem. In fact, they received correspondence from the CPA firm which assured them that the appropriate extension had been filed. Ultimately, the taxpayer was assessed \$200,000 for 20 delinquent Forms 5472. The taxpayer has never been delinquent in filing returns or extensions in the past. Further, the delinquent return was filed within the extension period. However, the taxpayer was not granted first time abatement from the AMS Campus review. You reviewed transcripts to verify the good filing history and the letter of confirmation received by the taxpayer from the CPA firm. How should Appeals resolve this case? Technically, there are no hazards involved because of Boyle and other Tax Court cases that support the conclusion that the taxpayer cannot rely on others to ministerial file their tax returns or file extensions.

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

Answer:

Classic example for mitigation since there are technically no hazards according to Counsel because of the relevant court case precedence. Therefore, there is unexcused delinquency but the taxpayer demonstrated a level of business care by relying on the letter from the CPA firm. As a result, it is appropriate to mitigate the penalty – not to zero since mitigation is a reduction not full abatement and also because we don't want to emulate first time abatement which is a policy that we don't follow in Appeals. Mitigating the penalty to 25% to 30% of the assessed penalty would be acceptable depending on all facts and circumstances involved.

What would be our official answer?

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

Answer:

The objective is to sustain a penalty that is sufficient to produce corrective action yet not hinder voluntary compliance. Refer to the four IRM objectives:

- **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.**

What would be our official answer?

Partial Penalty Abatement Based on a Penalty Policy and Mitigation

ACM Language:

As mentioned earlier, there should be multiple factors supporting mitigation and these should be discussed in great detail. In addition, cite Boyle below and the IRM below.

As held in *United States v. Boyle*, 85-1 USTC ¶ 13602 (S. Ct. 1985), the Courts has said that reasonable cause must be determined based on the demonstration of the taxpayer that he exercised “ordinary business care and prudence” but nevertheless was unable to comply with the law. Relying on this standard the courts seldom find reasonable cause for the late filing of a return. The Supreme Court in Boyle, stated that, “It takes no special training or effort to ascertain a deadline and make sure it is met.” This bright line standard issued by the courts requires that reasonable cause can only be established through an extraordinary event through which a taxpayer made a reasonable effort to attempt to comply. However, there are several mitigating factors that must be considered. . . .

Internal Revenue Manual 20.1.1.2.1 (6) states that “Compliance is achieved when a taxpayer normally makes a good faith effort.” to meet the requirement of the law. Internal Revenue Manual 20.1.1.2.1 (8) states “Penalties should 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.”

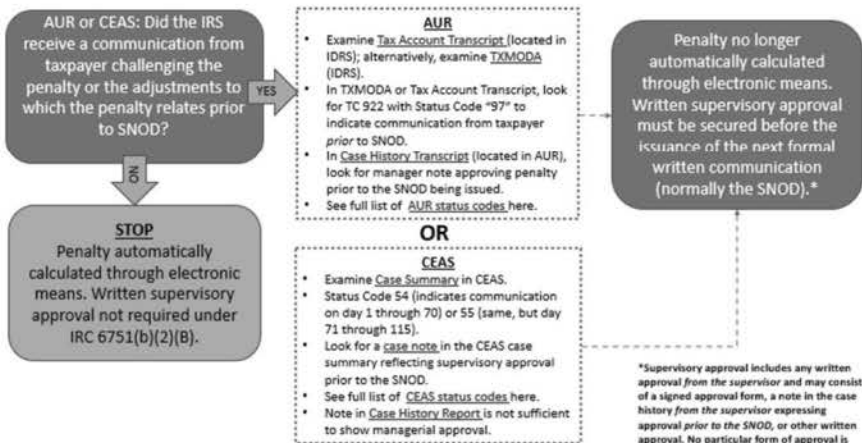
Based on the mitigating factors discussed in this case, in combination with IRM 20 – it is my recommendation to propose. . .

What would be our official answer?



Independent Determination

Independent determination in AUR or CEAS to impose the penalty ?





Approval Forms AUR Program

- Manager generally must input a note indicating concurrence with penalty.
- Notation must identify the penalty being approved and include statement of approval. See I.R.M. 20.1.5.2.3.1(5), Documenting Supervisory Approval of Penalties.

USER: [REDACTED] NOTE TRANSCRIPT

DATE 09/05/2020 SENSITIVE BUT UNCLASSIFIED PAGE 1

PRIM SSN CASE LOCATION [REDACTED] TAX YEAR 2016
SEC SSN

NOTE DATE 07/03/2018

NOTE: Request for penalty abatement denied. Going thru a messy divorce for 5 years is not reasonable cause. Managerial approval.

NOTE DATE 07/03/2018 Prior to 7/30/18 SND

NOTE: Per IRC 6751(b)(1), I concur with my subordinate's independent determination not to waive the Accuracy Related Penalty for Negligence (IRC 6662(b)(1) or Substantial Understatement of Tax (IRC 6662(d)).





Approval Forms

Correspondence Examination Automation Support Cases

- Manager generally must input a report generation software (RGS) non-action notation to indicate concurrence with penalty.
- Notation must identify the penalty being approved and include statement of approval. See I.R.M. 20.1.5.2.3.1(5), Documenting Supervisory Approval of Penalties.

Correspondence Examination Automation Support March 11, 2019 12:12 PM

Logon ID: WFF02 For Official Use Only | 2/20/2018

DEAS Version: 1.18.0 Compass

Case Status

TRE: Taxpayer's Name: Tax Period: 201412

Open Action Notes

Date	Submitted by	Submitter's EEO	Compass	Submitter's Group	Note
There are no action notes associated with this case.					

Closed action notes and Non-action notes

Date	Submitted by	Submitter's EEO	Compass	Submitter's Group	Action Type	Note
04/12/2017	SOLOMON FVETTE	K098B	PSC	23	Action	FOIA requesting a copy of BSA-A that addresses the case number 2017-1 and stating that a copy of the IRS in issue 2/17 for BSA-A addresses the case number 2017-1. I will review with FOIA the documentation received per the whistleblower but she would still be something in writing.
02/16/2017	Bash Agay Clark	UNKNOWN	PSC	80	Action	The 28 transaction to insert specific flow into an existing case for 580772005-AGC04-C00003 failed because the CEAS System has a problem with the transaction. The amount. The case sending the 28 transaction was not in the right category and group code (2000 vs case 2011). Please contact your system administrator for help reviewing the flow that was to be added.
02/01/2017	SARIS J HAYEL	3778B	PSC	25	Non-Action	This FOIA request discussed the 2014 Don C report. FOIA was on the 2 also verified this info. FOIA written an update on the case since no info have been sent our recently. I explained that a DISCO would be sent out in 2-3 weeks. Explained the purpose of the letter and findings involved. FOIA stated that the 30 does not cover a business. I should not have had a Don C and a Don A. Sent over the docs required for the screen, employer expense report. FOIA will be sending in all the required docs and a Form 1042C to remove the DISCO amount. FOIA had no other questions.
11/09/2016	LINDA A MAH	K098B	PSC	11	Non-Action	Manager approved of the Substantial Overstatement of Income Tax Penalty.
11/09/2016	SHARON WILLIAMS	T090E	PSC	11	Non-Action	ASCD 04/15/2018





Approval Forms Case Activity Record

- A case activity record signed by the employee’s manager is generally not sufficient to satisfy 6751(b). See *Purvis v. Commissioner*, T.C. Memo 2020-13.
- However, supervisory approval may be memorialized on the case activity record if it is clear the supervisor’s signature is intended as written approval of penalty.

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Case History Report

Examining officer: Example, E. Tax period(s): 201412 Page number: 1

Taxpayer:
Address:
Telephone:
Pin number:

Date	Location	Action	Tax Period(s)	Exam Time	Claim Time	Next Action Due
09/27/2018	Other	ICL - L564, B9-A, DCA	201412	0.3	0.0	
11/08/2018	Campus / Service Center	Case re-eval. dated 10/28/2018	201412	0.0	0.0	
11/08/2018	Campus / Service Center	Sealing 5250r - 4549r, A-B04r	201412	1.0	0.0	
11/01/2018	Campus / Service Center	ASSED 04/15/2018	201412	0.0	0.0	
Remarks: This note is created by the user XXXXX from service center 28 on 11-08/2018						
11/08/2018	Campus / Service Center	Manager approval of the Seibus	201412	0.0	0.0	
Remarks: This note is created by the user XXXXX from service center 28 on 11-08/2018						
Per IRC 6751, L. May Manager, consent with E. Example's determination to impose a penalty pursuant to IRC 6602.						



7-9-21. Stopped.



Reasonable Cause
Forms 8805
and 1042S

Objectives:

- 1. Identify the Relevant Code and Regulations that provide penalty provisions and reasonable cause relief for the most recurring international penalties.**
- 2. Discover some unique reasonable cause regulation provisions that are applicable to some international penalties.**

Objectives (Continued)

- 3. Be able to describe the details of these reasonable cause provisions and be able to apply them.**



Penalty Provisions

Penalty – Failure to File Form Number	Penalty Code Section	Reasonable Cause Code or Regulation
5471	6038	Treas Regulation 1.6038-2(k)(3)
5472	6038A	Treas Regulation 1.6038A-4(b)
3520	6048 6039	6677(d) 6039(F)(c)(2)
1042	6651	6651 & Treas Regulation 301.6651
8804	6651	6651 & Treas Regulation 301.6651

What About Forms:

8805??

1042-S??



Penalty Provisions

Penalty – Failure to File Form Number	Penalty Code Section	Reasonable Cause Code or Regulation
8805	Code Section 6721	Code Section 6724 and Treasury Regulation 301.6724
1042-S	Code Section 6721	Code Section 6724 and Treasury Regulation 301.6724



Statutory Authorities

- **Code Section 6721:**

Provides for a penalty for the failure to file certain international information returns.

- **Code Section 6722:**

Provides for a penalty for the failure to furnish correct payee statements.

- **Code Section 6724:**

Provides for a general reasonable cause waiver.

- **Treasury Regulations 301.6724**

Provides the expansive criteria for reasonable cause relief.

26 U.S. Code § 6721 - Failure to file correct information returns

- (a) Imposition of penalty (1) In general In the case of a failure described in paragraph (2) by any person with respect to an information return, such person shall pay a penalty of \$250 for each return with respect to which such a failure occurs, but the total amount imposed on such person for all such failures during any calendar year shall not exceed \$3,000,000.

IRC 6721(b) provides for a reduction in the penalty depending on how late the returns are filed.

Penalty amounts have been revised over the years and are also subject to increases due to inflation.



Applicable Penalty Amounts

Where to Find the Applicable Penalty Amounts:

Exhibit 20.1.7-1 (12-09-2019) – Large businesses with gross receipts exceeding \$5 million

Exhibit 20.1.7-2 (12-09-2019) Small businesses with gross receipts less than \$5 million

These revenue procedures referenced in these procedures provide for inflationary adjustments.

Inflation adjustments are published at least annually via Revenue Procedures.



Exhibit 20.1.7-2 (12-09-2019)

Returns Due	Penalty Rate	Not more than 30 days late	31 days late - August 1	After August 1	Intentional disregard**
From 01-01-2021 thru 12-31-2021* (Rev. Proc. 2019-44)	Per return / Max	\$50 / \$197,500	\$110 / \$565,000	\$280 / \$1,130,500	\$560 / No max
From 01-01-2020 thru 12-31-2020* (Rev. Proc. 2018-57)	Per return / Max	\$50 / \$194,500	\$110 / \$556,500	\$270 / \$1,113,000	\$550 / No max
From 01-01-2019 thru 12-31-2019* (Rev. Proc. 2018-18)	Per return / Max	\$50 / \$191,000	\$100 / \$545,500	\$270 / \$1,091,500	\$540 / No max
From 01-01-2018 thru 12-31-2018* (Rev. Proc. 2016-55)	Per return / Max	\$50 / \$187,500	\$100 / \$536,000	\$260 / \$1,072,500	\$530 / No max



Due Dates

What are the due dates for Forms 1042-S?

Form 1042-S is due:

March 15 of the year following the calendar year in which the income subject to reporting was paid.



Due Dates

**What are the due dates for Forms 1042-S?
Extensions?**

Treasury Regulation 1.6081-8 states that an automatic extension of 30 days is provided when the taxpayer completes and files Form 8809.

An additional, non-automatic extension of 30 days is allowed if the first 8809 is timely filed. If so, then a second extension can be granted with a paper Form 8809.

Note: Extension for Form 1042 is Form 7004.



When is the Form 8805 due?

A foreign partner must receive a copy of Form 8805 by the due date of the partnership return (including extensions).

3-15 due date for tax years beginning after 12/31/2015.



Due Dates

When is the Form 8805 due?

Extensions:

(Can extend the due date of the Form 8804 with Form 7004. This, therefore, automatically extends the due date of the Form 8805 as well as the due date to provide copies to foreign partners.)

See Notice 2017-47

“Partnerships that receive an extension of time to File Form 8804 receive concurrent extensions of time to file Forms 8805 and to furnish respective copies of the Forms 8805 to their partners.”

Code Section 6724:

(a) Reasonable cause waiver. No penalty shall be imposed under this part with respect to any failure if it is shown that such failure is due to reasonable cause and not to willful neglect.

301.6724-1 Reasonable Cause

(2) Reasonable cause defined. The penalty is waived for reasonable cause only if the filer establishes that either -

- (i) There are significant mitigating factors with respect to the failure, as described in paragraph (b) of this section; or**
- (ii) The failure arose from events beyond the filer's control (“impediment”), as described in paragraph (c) of this section.**

Moreover, the filer must establish that the filer acted in a responsible manner, as described in paragraph (d) of this section, both before and after the failure occurred. Thus, if the filer establishes that there are significant mitigating factors for a failure but is unable to establish that the filer acted in a responsible manner, the mitigating factors will not be sufficient to obtain a waiver of the penalty. Similarly, if the filer establishes that a failure arose from an impediment but is unable to establish that the filer acted in a responsible manner, the impediment will not be sufficient to obtain a waiver of the penalty. See paragraph (g) of this section for the reasonable cause safe harbor for persons who exercise due diligence.

**How do we know that these 301.6724
regulations apply to Forms 8805 and 1042-S?**

301.6724-1(j):

(j) Failures to which this section relates. For purposes of this section, a failure relating to an information reporting requirement means -

- (1) A failure described under § 301.6721-1(a)(2) relating to the failure to file timely correct information returns as defined in section 6724(d)(1),**
- (2) A failure described under § 301.6722-1(a)(2) relating to the failure to furnish timely a correct payee statement as defined in section 6724(d)(2), and**
- (3) A failure described under § 301.6723-1(a)(2) relating to the failure to timely comply with and to include correct specified information as defined in section 6724(d)(3).**

§ 301.6721-1 Failure to file correct information returns.

(a) Imposition of penalty -

(1) General rule. A penalty of \$50 is imposed for each information return (as defined in section 6724(d)(1) and paragraph (g) of this section) with respect to which a failure (as defined in section 6721(a)(2) and paragraph (a)(2) of this section) occurs. No more than one penalty will be imposed under this paragraph (a)(1) with respect to a single information return even though there may be more than one failure with respect to such return.



Statutory Authorities

IRC 6724(d)(1)

26 U.S. Code § 6724 - Waiver; definitions and special rules

(d) Definitions. For purposes of this part—(1) Information return. The term “information return” means

Blah, blah, blah, blah.....

At the very bottom of this section....

“Such term also includes any form, statement, or schedule required to be filed with the Secretary under chapter 4 or with respect to any amount from which tax was required to be deducted and withheld under chapter 3 (or from which tax would be required to be so deducted and withheld but for an exemption under this title or any treaty obligation of the United States).”

Chapter 3 – Withholding of Tax on Nonresident aliens and Foreign Corporations)

Treasury Regulations 301.6721-1 (g)(4)

(4) Other items. The term information return also includes any form, statement, or schedule required to be filed with the Internal Revenue Service with respect to any amount from which tax is required to be deducted and withheld under chapter 3 of the Internal Revenue Code (or from which tax would be required to be so deducted and withheld but for an exemption under the Internal Revenue Code or any treaty obligation of the United States), generally Forms 1042-S, “Foreign Person’s U.S. Source Income Subject to Withholding,” and 8805, “Foreign Partner’s Information Statement of Section 1446 Withholding Tax.” The provisions of this paragraph (g)(4) referring to Form 8805, shall apply to partnership taxable years beginning after May 18, 2005, or such earlier time as the regulations under § § 1.1446-1 through 1.1446-5 of this chapter apply by reason of an election under § 1.1446-7 of this chapter.



Application of the Reasonable Cause

**The details are in Treasury Regulations 301.6724.
However, for ease of reference and procedural
clarification, IRM 20.1.7.1**

20.1.7.1 (10-12-2017)

Program Scope and Objectives

- (1) **Purpose:** This IRM provides policy and procedures for the application of information return penalties assessable under IRC 6721, IRC 6722, and IRC 6723. It also discusses reasonable cause criteria per IRC 6724 and 26 CFR 301.6724-1.
- (2) **Audience:** All operating division employees who address information return penalties



Reasonable Cause

Per IRM 20.1.7.12.1 (7):

Reasonable cause for the information return penalties generally exists when:

The filer acted in a responsible manner, both before and after the failure occurred, and

- (i) There are significant mitigating factors, or**
- (i) The failure was the result of circumstances beyond the filer's control.**



Reasonable Cause

(8) Acting in a Responsible Manner (26 CFR 301.6724-1(d))

generally includes exercising the same degree of care that a reasonably prudent person (or organization) would use in the course of its business in determining filing obligations and in handling account information such as account numbers and balances. The filer must act in a responsible manner both before and after the failure occurs. Acting in a responsible manner also includes taking steps to avoid the failure, for example:

Requesting appropriate extensions of time to file when practical to avoid the failure,

Attempting to prevent a failure if it was foreseeable,

**Acting to remove an impediment or the cause of the failure,
and**

**Correcting the failure as promptly as possible, generally within
30 days.**



Reasonable Cause

(10) When reviewing a filer's request for a waiver, the following questions must be addressed to determine if the filer has acted in a responsible manner:

1. Do the reasons address the penalty that was assessed?

2. Does the length of time between the event cited as a reason and the filing date negate the event's effect?

3. Does the continued operation of a business after the event that caused the filer's noncompliance negate the event's effect?

4. Should the event that caused the filer's noncompliance or increased liability have reasonably been anticipated?

5. Was the penalty the result of carelessness or did the filer appear to have made an honest mistake? Note: Carelessness and forgetfulness are not examples of ordinary business care and prudence.

6. Has the filer provided sufficient detail (dates, relationships) to determine whether they exercised ordinary business care and prudence?

- 7. Is a non-liable person being blamed for the filer's noncompliance? What is the nature of the relationship between the taxpayer and the individual? Is the individual an employee of the taxpayer or an independent third party, such as an accountant or lawyer?**

- 8. Has the filer documented all pertinent facts, i.e. death certificate, doctor's statement, insurance statement for proof of fire, etc.?**

- 9. Does the filer have a history of being assessed the same penalty?**

- 10. Could the filer have requested an extension or filed an amended return?**

(12) Significant mitigating factors - For the filer to establish reasonable cause under this category, the filer must show that they acted in a responsible manner as well as the existence of a significant mitigating factor. Events generally considered to be significant mitigating factors include, but are not limited to:

First time filer - prior to the failure, the filer had not previously been required to file this particular form or statement.

The filer has a history of complying with the information return reporting requirements.

Significant consideration is given to if the filer was previously penalized under IRC 6721, IRC 6722, or IRC 6723.



Circumstances beyond the filer's control:

1. Actions of the IRS

2. Action of an Agent:

The filer exercised reasonable business judgment when contacting the agent, allowing the agent to timely file correct returns, or furnish correct payee statements.

3. Actions of a Payee or Any Other Person.

Actions of an Agent (continued)

The filer provided the agent with proper information well in advance of the due date of the return or statement, and

- **the agent satisfied the significant mitigating factors,**
- **or an event beyond the agent's control occurred that could establish reasonable cause.**

A filer who contracted with an agent and cannot establish reasonable cause based on the actions of the agent as described above, may be able to demonstrate reasonable cause on his/her own merit by having an established history of complying with the information reporting requirements, and otherwise acting in a responsible manner both before and after the failure occurred.

(Demonstrates that they acted in a responsible manner and they had significant mitigating factors.)



Circumstances Beyond Control

Actions by the payee or any other person --For the filer to establish reasonable cause as the result of actions by the payee or any other person with respect to the return or payee statement, the filer must show that:

The payee, or other person, failed to provide the necessary information to the filer, or

The payee, or other person failed to provide correct information to the filer.

The filer made available to the payee all necessary information to complete the filing

The filer must provide documentary evidence when requested by the IRS showing that the failure was attributable to the payee.

(19) Unavailability of business records

The business records must have been unavailable as a result of unforeseen conditions, and in a manner which would prevent timely compliance (ordinarily at least a two week period prior to the due date or extended due date) of the information return, and the unavailability was caused by a supervening event. # In the case of a corporation, estate, trust, *etc.*, the death, serious illness, or unavoidable absence of a member of the immediate family of the person having sole authority to file the information return may constitute reasonable cause. #

See this IRM 20.1.7.12.1 for additional guidance

How these reasonable cause provisions differ from the reasonable cause provisions of other international penalties:

- 1. Only penalty regulations that actually provide “mitigation” factors.**
- 2. Can result in first time abatement.**
- 3. Can sometimes get relief for relying on someone else to file the returns.**

You have met the following objectives:

- 1. Reviewed the penalty and reasonable cause relief provisions for most international penalties.**
- 2. Identified the penalty and reasonable cause provisions applicable to Forms 8805 and 1042-S.**
- 3. Reviewed these special provisions in order to be prepared to use them on 8805 and 1042-S penalty cases.**



5472 Form - 2018

New 2018 Filing Requirements

Form 5472 is now 3 pages long.

Part VII includes questions 5a & b and 6 a through d as well as
Part VIII, 1-5.

Parts VII and VIII contain questions relative to FDII and BEAT.

1. Four questions deal with dollar amounts relating to FDII.
2. Three questions deal with Base Erosion payments and tax benefits.
3. One question deals with payments to a related party which are not allowed because they are disallowed payments under the new hybrid rules. (Deduction allowed in one country but amount is not included in income in the other.)

Summary:

- Form 5472 has grown from 2 pages to 3.
- 2017 - expanded reporting requirement to include foreign owned US disregarded entities (when applicable)
- Expanded the number/type of reportable transactions for foreign owned US disregarded entities.
- 2018 - Requires identification of certain BEAT, 267A and FDII payments which are part of the disclosed foreign related party transactions.

This expansion may be the reason that the penalty has increased to \$25,000 from \$10,000.

International Information Returns and Related Penalties

Area 2 Team 3 Settlement Officer International

Penalty Assessments

- Penalties are assessed under MFT 13 (BMF) and MFT 55 (IMF)
- Posted with a TC240 and a penalty reference number
- Form 8278 Assessment and abatement of miscellaneous civil penalties.
- Form 8278 is an eight page document that contains a listing of the IRC section and the item reference code for each penalty.
- *These penalty assessments are not subject to deficiency procedures and do not have post assessment appeal rights. The assessment notice informed the taxpayer of the appeals procedure, if applicable*

Reference	Description	Form	Deficiency Proceedings
<u>IRC 6038(b)</u>	Information Reporting With Respect to Certain Foreign Corporations and Partnerships—Penalty for Failure to Furnish Information	<u>Form 5471</u> , <u>Form 8858</u> , or <u>Form 8865</u>	No
<u>IRC 6038(c)</u>	Penalty of Reducing Foreign Tax Credit Plus Continuation Penalty	<u>Form 5471</u> , <u>Form 8858</u> , or <u>Form 8865</u>	Yes
<u>IRC 6038A(d)</u>	Information Reporting for Foreign-Owned Corporations	<u>Form 5472</u>	No
<u>IRC 6038A(e)</u>	Noncompliance Penalty for Failure to Authorize an Agent or Failure to Produce Records	Not applicable	Yes
<u>IRC 6038B(c)</u>	Failure to Provide Notice of Transfers to Foreign Persons	<u>Form 926</u> or <u>Form 8865 Schedule O</u>	No for penalty. Yes for tax on gain
<u>IRC 6038C(c)</u>	Information With Respect to Foreign Corporations Engaged in U.S. Business	<u>Form 5472</u>	No
<u>IRC 6038C(d)</u>	Noncompliance Penalty for Foreign Related Party Failing to Authorize the Reporting Corporation to Act as its Limited Agent	Not applicable	Yes
<u>IRC 6038D</u>	Failure to Provide Information With Respect to Specified Foreign Financial Assets	<u>Form 8938</u>	No
<u>IRC 6039E</u>	Failure to Provide Information Concerning Resident	Not applicable	No

Reference	Description	Form	Deficiency Proceedings
<u>IRC 6039F(c)</u>	Gifts from Foreign Persons	<u>Form 3520</u>	Yes if <u>IRC 6039F(c)(1)(A)</u> . No if <u>IRC 6039F(c)(1)(B)</u> .
<u>IRC 6039G</u>	Expatriation Reporting Requirements	<u>Form 8854</u> , <u>Form W-8CE</u>	No
<u>IRC 6652(f)</u>	Foreign Persons Holding U.S. Real Property Investments	Not applicable	No
<u>IRC 6677(a)</u>	Failure to File a Foreign Trust Information Return	<u>Form 3520</u>	No
<u>IRC 6677(b)</u>	Failure to File an Information Return With Respect to U.S. Owners of a Foreign Trust	<u>Form 3520-A</u>	No
<u>IRC 6679</u>	Return of U.S. Persons With Respect to Certain Foreign Corporations and Partnerships	<u>Form 5471</u> Schedule O, <u>Form 8865</u> Schedule P, or <u>Form 5471</u> Schedule N	No
<u>IRC 6686</u>	Information Returns for Former FSCs	<u>Form 1120-IC-DISC</u> , or <u>Form 1120-FSC</u>	Yes
<u>IRC 6688</u>	Reporting for Residents of U.S. Possessions	<u>Form 5074</u> , <u>Form 8689</u> or <u>Form 8898</u>	Yes
<u>IRC 6689</u>	Failure to File Notice of Foreign Tax Redetermination	<u>Form 1116</u> or <u>Form 1118</u> (attach to <u>Form 1040-X</u> or <u>Form 1120-X</u>)	No
<u>IRC 6712</u>	Failure to Disclose Treaty-Based Return Position	<u>Form 8833</u>	No

Penalty Abatement Requests

International return penalties have been assessed by exam.

Penalties assessed by exam can only be abated with the concurrence of International Examination

As AO's and SO's we have the authority to abate the penalty unless the taxpayer has signed some type of agreement or it is precluded from consideration.

Penalty Criteria

Penalties can be assessed prior to the filing of the required returns.

Penalties can also be assessed for returns that were filed but did not include all the required information.

Reasonable Cause Criteria

The fact that reasonable cause was accepted for failure to timely file the income tax return does not automatically provide reasonable cause for the information return. Most penalties have reasonable cause provisions

Reasonable Cause /Continuation Portion Penalty

Reasonable cause does not apply to the continuation portion of the penalty.

The continuation portion begins when the taxpayer is issued a notice letter and does not file the required returns within ninety days of the issuance of the letter.

For assessments made after 6/2005, these assessments will have a reference number of 619

Abatement Requests

Assessment document should have

- 1. the penalty computation,**
- 2. documentation of discussions held with the taxpayer on reasonable cause or requirement to file, and**
- 3. copies of filed returns**

IRM 8.11.5

Penalties Worked in Appeals, International Penalties (revised 12/18/2015)

During Fiscal Year 2014, the Appeals International Penalty Internal Revenue Manual (IRM) was reorganized to incorporate all post-assessed International penalties worked in Appeals.

Form 5471 – Continued

IRC 6038 imposes a penalty for failure to timely file complete and accurate Forms 5471 by U.S. persons possessing more than 50% of the total combined voting power of all classes of all shares of stock, or the total value of all shares of stock

The penalty can be waived if reasonable cause exists.

Penalty applies to each F5471 that was required. It is required to be filed on the same date as the related tax returns. Analysis of tax modules on related returns may be needed for required dates

True OR FALSE – Question 3

Reasonable cause applies to the continuation portion of the failure to file information returns.

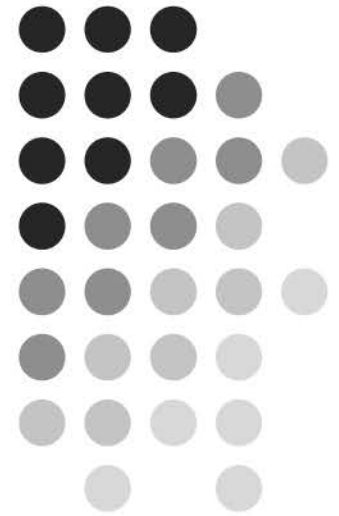
FALSE - IRM 20.1.9.3.5

20.1.9.3.5
(07-08-2015)
Reasonable Cause

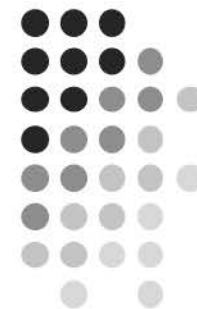
- (1) **Initial Penalties**—To show that reasonable cause exists, the person required to report such information must be in compliance with all open reporting years (not on extension) and must make an affirmative showing of all facts alleged as reasonable cause for such failure in a written statement. For failure to file Form 5471, the written statement must contain a declaration that it is made under the penalties of perjury. Additional information is available for the following:
 - a. Form 5471 see Treas. Reg. 1.6038-2(k)(3)
 - b. Form 8865 see Treas. Reg. 1.6038-3(k)(4).
- (2) **Continuation Penalty**—There is no reasonable cause exception for this penalty.
- (3) **PRN 599 and PRN 712 Penalties**—The first-time abatement (FTA) penalty relief provisions (see IRM 20.1.1.3.6.1(8), exception) generally do not apply to event-based filing requirements such as with Form 5471. However, if the

Form 8858

Return of U.S. Persons With
Respect to Certain Foreign
Disregarded Entities



Form 8858



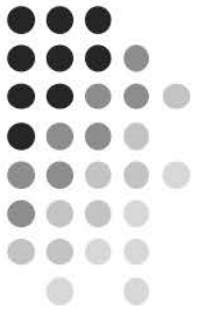
Filed by all US owners of Foreign Disregarded Entities

Due by the due date of the owner's income tax return,
including extensions

Filed as an attachment to:

- Form 5471 if owned by a CFC
- Form 8865 if owned by a CFP
- Form 1040 if owned by an individual

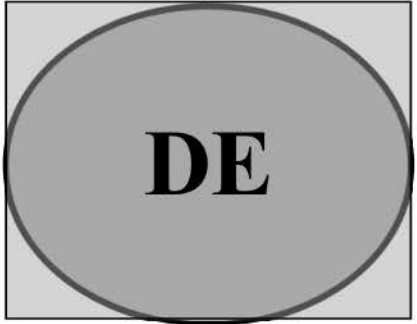
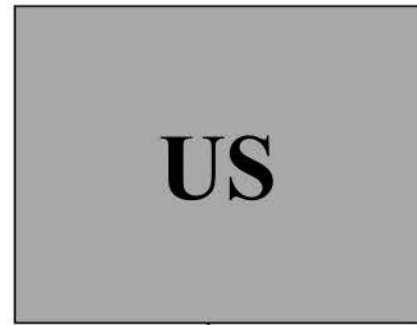
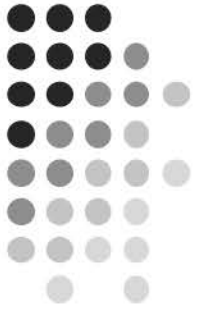
Form 8858 - Failure to File Penalty



No statutory requirement to file, therefore
no specified penalty for failure to file

However, failure to file for lower tier DE
makes corresponding 5471 or 8865
“substantially incomplete”

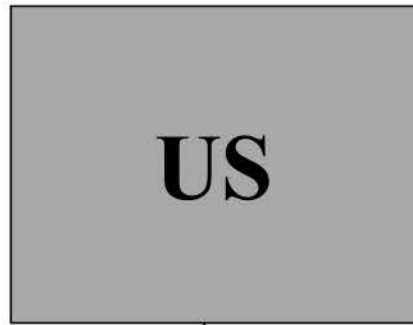
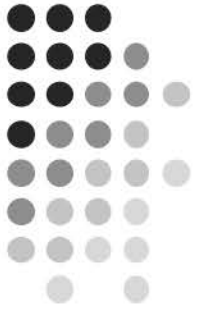
Form 8858



First tier DE

**No penalty applies if TP fails to file
Form 8858 for first tier DE**

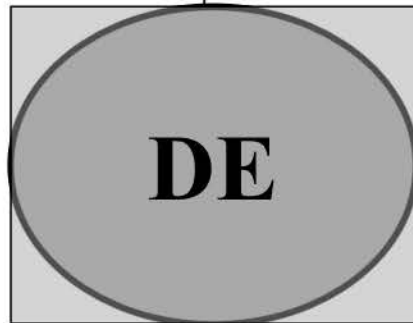
Form 8858



US files form 5471 for CFC



CFC files F8858 for DE



**If no 8858, 5471 is
“substantially incomplete”**

IRC SECTION 6038

- ^{(g)(a)}, Appeals Officer International Specialist, Houston, Texas.

- ^{(g)(b)}
-
-
-

- No review and Concurrence.

SECTION 6038 ISSUES

- Taxpayer claims there was no filing requirement.
- Taxpayer claims filed 5471 contained enough information.
- Taxpayer requests reasonable cause exception to penalty.

SECTION 6038 PENALTIES

- \$10,000 penalty per required Form 5471 for failure to file, late filing or incomplete information. IRC 6038(b)(1).
- Increase in the penalty where failure continues after notification. 90 days after notification, \$10,000 continuation penalty for each 30 day period up to a maximum continuation of \$50,000. IRC 6038(b)(2).
- There is no reasonable cause relief for the continuation penalty. IRC 6038(c)(4)(b).

TYPES OF CASES

- Service Center. If a taxpayer filed a late 5472, the service center will assess the penalty.
- Examination. If a revenue agent finds unfiled 5472's or those without the proper information.

SERVICE CENTER CASES

- 5472 is attached to a tax return, but the tax return was filed late. There are a lot of these types of cases.

REASONABLE CAUSE

- IRC 6038(c)(4)(B) and Treasury Regulation 1.6038-2(k)(3) allow for reasonable cause to abate the penalty.
- Section 6038 does not include a provision defining reasonable cause for failure to furnish the required information within the time prescribed.

REASONABLE CAUSE

- Regulations 1.6038-2(k)(3)(ii), last sentence, “In the case of a return that has been filed as required by this section except for an omission of, or error with respect to, some of the information required, if the person who filed the return establishes to the satisfaction of the district director or the director of the service center that the person has substantially complied with this section, then the omission or error shall not constitute a failure under this section.

REASONABLE CAUSE

- Chief Counsel Advice 200748006.
- The same standards used for determining failure to file penalties under Section 6651 should be used in determining penalty under Section 6038.

REASONABLE CAUSE

- Chief Counsel Advice 200748006 continued.
- The language in Section 6038 is “...reasonable cause...”.
- The language in Section 6651 is “...reasonable cause and not due to willful neglect...”.

REASONABLE CAUSE

- IRS Legal Memorandum. 2006 TNT 219-23.
- Form 5471's were not substantially complete.

REASONABLE CAUSE

- Policy Statement 20-1.
- Penalties are used to enhance voluntary compliance.
- IRM 20.1. Penalty Handbook.
- IRM 20.1.9. Penalty Handbook, International Penalties.

REASONABLE CAUSE

- Supreme Court case of *United States v. Boyle*, 469 U.S. 241 (1985).
- The taxpayer must show that he exercised ordinary business care and prudence.
- Taxpayer can not rely on someone else to file a return.

REASONABLE CAUSE

- *Haynes v. United States*, 760 F. Appx. 324 (5th Circuit, 2019).
- Does Boyle case apply to e-filing?
- Preparer attempted to e-file; return was transmitted, but rejected by IRS.
- Preparer and taxpayer were unaware of rejection.
- Preparer told taxpayer return was filed.

REASONABLE CAUSE

- *Haynes* continued.
- Eventually IRS notified taxpayer that return never received; sent in paper return.
- Failure to file penalty assessed; taxpayer paid and filed claim for refund.
- Argued reasonable cause based on reliance on preparer. IRS said *Boyle*.
- District Court agreed with IRS. Summary judgment. Taxpayer appealed.

REASONABLE CAUSE

- *Haynes* continued.
- 5th Circuit declined to answer whether *Boyle* covered e-filing. January 2019.
- Summary judgment should not have been granted and sent it back to the District Court for additional work.
- District Court issued Order of Dismissal on June 5, 2019.

REASONABLE CAUSE

- *Estate of Thouron v. United States*, 752 F.3d 311, 3rd Circuit, 2014.
- The Court broke down *Boyle* into three distinct set of facts.
- 1.) Relying on agent for ministerial act of filing or paying;
- 2.) Return filed after the due date but within time advisor erroneously conveyed;

REASONABLE CAUSE

- 3.) Accountant or attorney advises on a matter of tax law.
- 3rd Circuit said categories 2 & 3 are entitled to reasonable cause relief.

REASONABLE CAUSE

- Reliance on a professional.
- *Neonatology Associates, P.A. v. Commissioner*, 115 TC 43.
- Tax Court laid out 3 requirements for reasonable cause based on professional reliance.

REASONABLE CAUSE

- *Neonatology* factors.
- 1. Advisor was competent and sufficiently experienced;
- 2. Taxpayer provided necessary and accurate information to the advisor;
- 3. Taxpayer actually relied in good faith on the advisors judgment.

REASONABLE CAUSE

- *Estate of Esther M. Hake v. U. S. U.S. District Court, M.D. Pennsylvania. 119 AFTR 2d 2017-727. February 10, 2017.*
- Court sided with taxpayer on late penalty due to reliance on attorney saying there was a one year extension when there was only a six month extension.

REASONABLE CAUSE

- Other cases where the preparer provided specific advice to the taxpayer and the taxpayer met reasonable cause:
- *Coldwater Seafood Corp v. Commission*, 69 TC 966 (1978), the taxpayer was granted relief because he relied on his accountant who erred in saying that payments were not interest and therefore not subject to withholding under Section 1441.

REASONABLE CAUSE

- *Thousand Oaks Residential Care Home v. Commissioner*, TC Memo 2013-10 – the accountant advised that a Form 5330 was not required because compensation paid was reasonable.
- *Housden v. Commissioner*, TC Memo 1992-91, law firm tax partner advised the taxpayer that he was not responsible for withholding taxes and therefore was not required to file Form 1042.

REASONABLE CAUSE

- *Congdon v. United States*, 108 AFTR 2d 2011-6340. US District Court, Eastern District of Texas.
- US filed for Summary Judgment. Court denied.
- Court gave good explanation of what is needed for reasonable cause analysis regarding Form 5471.

REASONABLE CAUSE

- *Congdon* case continued.
- Court refers to IRM and other sections of Code.
- “The elements that must be present to constitute reasonable cause are a question of law, but whether those elements are present in a given situation is a question of fact.”

REASONABLE CAUSE

- *Congdon* case continued.
- “However, reasonable cause may be established if the taxpayer shows ignorance of the law in conjunction with other facts and circumstances.”
- “Generally, the most important factor in determining whether the taxpayer has reasonable cause and acted in good faith is the extent of the taxpayer’s effort to report the proper tax liability.”

REASONABLE CAUSE

- *Congdon* case continued.
- “Failure to file because of an erroneous belief that no return is required to be filed is not reasonable cause.”
- “...a taxpayer’s sophistication with respect to tax laws, at the time the return was filed, is relevant in determining whether the taxpayer acted with reasonable cause.”

REASONABLE CAUSE

- Other factors need to be looked at.
- Filing history. IDRS work.
- Reasons why return was late. Method.
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- Case Memorandum must contain good explanation of your reasonable cause decision.
- Reasonable cause means different things to different people.

MITIGATION

- The action of reducing the severity, seriousness, or painfulness of something.
- Mitigation in appeals, therefore, would be reducing the penalty assessed – not based on hazards but based on penalty policy.
- However, the extent of mitigation is dependent upon the taxpayer's favorable factors which demonstrate ordinary business care and prudence.

MITIGATION

- Mitigation applies when there are minimal or no hazards.
- Could be used to “mitigate” the penalty based on positive factors and penalty policy.

MITIGATION

- Encouraging voluntary compliance.
- IRM 20.1.1.2.1.
- Policy Statement 20-1.

MITIGATION

What is our authority for practicing penalty mitigation?

We are the only function with delegated authority for resolving tax disputes. IRM 1.2.17.2(3)

IRM 20.1.1.2.1 states that 8) The IRS has the obligation to advance the fairness and effectiveness of the tax system.

MITIGATION

IRM 20.1.1.2.1 states penalties should:

- 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.

MITIGATION

- Mitigation generally means reducing a penalty and not reducing it to zero.
- Further, mitigation to zero is not appropriate if it mimics the first time abatement.
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- Since assessments will have been made, taxpayers will not be able to go to Tax Court. US District Court or US Court of Claims will be venue.
- But taxpayers can “backdoor” into Tax Court through CDP. *Flume v. Commissioner*, TC Memo 2017-21.

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- Section 6038 penalties are not subject to deficiency procedures, and thus the United States Tax Court.
- Plaintiff's only remaining avenue to challenge the 6038(b) penalty is to pay the amount at issue and then sue for a refund.


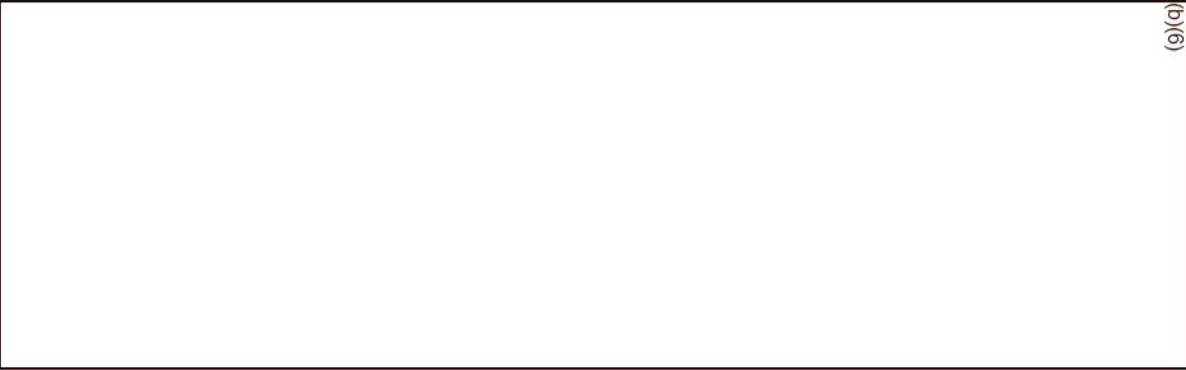
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- Erin Collins is the new Taxpayer Advocate.

OVERALL

- There's a lot of different information and ways to look at the penalty.
- Reasonable cause? Mitigation?
- *Boyle? Haynes? Neonatology?*
- However you decide, your case memorandum must contain a good explanation of how you reached your decision.

IRC SECTION 6038A

-  Appeals Officer International Specialist, Houston, Texas.
- 
- No review and concurrence.

IRC SECTION 6038A

- Titled: “Information With Respect To Certain Foreign-Owned Corporations.”
- Required of United States corporations which are 25% foreign owned.
- Heightened enforcement in the last few years.
- Beginning in 2013, Master File systemically assessed 6038A penalty on 5472's attached to late filed 1120's. IRM 21.8.2.21.2(1).

IDRS

- Must check IDRS for prior and subsequent filings. Payment information also.
- Filing history and compliance since penalty are important factors.
- If there are penalties in other years not assigned, you should work all of them. Check with ATM.

TYPES OF CASES

- Service Center. If a taxpayer filed a late 5472, the service center will assess the penalty.
- Examination. If a revenue agent finds unfiled 5472's or those without the proper information.

STATUTE

- Section 6038A penalties can be assessed without statutory notice of deficiency procedures.
- When you receive a case, the penalty should already be assessed. The penalty should be assessed under MFT 13. To verify the assessment and statute, secure the proper IDRS information.

REASONABLE CAUSE

- IRC 6038A(d)(3) and Treasury Regulation 1.6038A-4(b) allow for reasonable cause to abate the penalty.
- Section 6038A does not include a provision defining reasonable cause for failure to furnish the required information within the time prescribed.

REASONABLE CAUSE

- Regulations 1.6038A-4(b)(2)(iii), starts, “Facts and circumstances taken into account. The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances.”

REASONABLE CAUSE

- Regulations 1.6038A-4(b)(ii) Small corporations.
- “The District Director shall apply the reasonable cause exception liberally in the case of a small corporation that had no knowledge of the requirements imposed by section 6038A; has limited presence in and contact with the United States; ...

REASONABLE CAUSE

- “...and promptly and fully complies with all requests by the District Director to file Form 5472, and to furnish books, records, or other materials relevant to the reportable transaction. A small corporation is a corporation whose gross receipts for a taxable year are \$20,000,000 or less.”

REASONABLE CAUSE

- Small Corporation Exception.
- Not in the Code; Regulations only.
- In House of Representative part.
- Included three of four requirements.
- Did not include gross receipts test.
- \$20,000,000 gross receipts put in Regulations by Treasury / IRS.

REASONABLE CAUSE

- Many Service center cases will fall into the small corporation gross receipts category.
- Subjective analysis for knowledge of the requirements and limited presence.

REASONABLE CAUSE

- Continuation penalty. Examination sourced cases.
- There is no reasonable cause relief for the continuation penalty. IRC 6038A(d)(3).
- However, if taxpayer can show 5472 was not required, penalty can be abated.
- Penalty can also be assessed for incomplete 5472. Open to interpretation.

REASONABLE CAUSE

- Policy Statement 20-1.
- Penalties are used to enhance voluntary compliance.
- IRM 20.1. Penalty Handbook.
- IRM 20.1.9. Penalty Handbook, International Penalties.
- Filing and penalty history.
- Current compliance.

REASONABLE CAUSE

- Supreme Court case of *United States v. Boyle*, 469 U.S. 241 (1985).
- The taxpayer must show that he exercised ordinary business care and prudence.
- Taxpayer can not rely on someone else to file a return.

REASONABLE CAUSE

- *Haynes v. United States*, 760 F. Appx. 324 (5th Circuit, 2019).
- Does Boyle case apply to e-filing?
- Preparer attempted to e-file; return was transmitted, but rejected by IRS.
- Preparer and taxpayer were unaware of rejection.
- Preparer told taxpayer return was filed.

REASONABLE CAUSE

- *Haynes* continued.
- Eventually IRS notified taxpayer that return never received; sent in paper return.
- Failure to file penalty assessed; taxpayer paid and filed claim for refund.
- Argued reasonable cause based on reliance on preparer. IRS said Boyle.
- District Court agreed with IRS. Summary judgment. Taxpayer appealed.

REASONABLE CAUSE

- *Haynes* continued.
- 5th Circuit declined to answer whether *Boyle* covered e-filing. January 2019.
- Summary judgment should not have been granted and sent it back to the District Court for additional work.
- District Court issued Order of Dismissal on June 5, 2019.

REASONABLE CAUSE

- *Estate of Thouron v. United States*, 752 F.3d 311, 3rd Circuit, 2014.
- The Court broke down *Boyle* into three distinct set of facts.
 - 1. Relying on agent for ministerial act of filing or paying;
 - 2. Return filed after the due date but within time advisor erroneously conveyed;

REASONABLE CAUSE

- 3. Accountant or attorney advises on a matter of tax law.
- 3rd Circuit said categories 2 & 3 are entitled to reasonable cause relief.

REASONABLE CAUSE

- Reliance on a professional.
- *Neonatology Associates, P.A. v. Commissioner*, 115 TC 43.
- Tax Court laid out 3 requirements for reasonable cause based on professional reliance.

REASONABLE CAUSE

- *Neonatology* factors.
- 1. Advisor was competent and sufficiently experienced;
- 2. Taxpayer provided necessary and accurate information to the advisor;
- 3. Taxpayer actually relied in good faith on the advisors judgment.

REASONABLE CAUSE

- *Estate of Esther M. Hake v. U. S. U.S. District Court, M.D. Pennsylvania. 119 AFTR 2d 2017-727. February 10, 2017.*
- Court sided with taxpayer on late penalty due to reliance on attorney saying there was a one year extension when there was only a six month extension.

REASONABLE CAUSE

- Other cases where the preparer provided specific advice to the taxpayer and the taxpayer met reasonable cause:
- *Coldwater Seafood Corp v. Commission*, 69 TC 966 (1978), the taxpayer was granted relief because he relied on his accountant who erred in saying that payments were not interest and therefore not subject to withholding under Section 1441.

REASONABLE CAUSE

- *Thousand Oaks Residential Care Home v. Commissioner*, TC Memo 2013-10 – the accountant advised that a Form 5330 was not required because compensation paid was reasonable.
- *Housden v. Commissioner*, TC Memo 1992-91, law firm tax partner advised the taxpayer that he was not responsible for withholding taxes and therefore was not required to file Form 1042.

REASONABLE CAUSE

- *Congdon v. United States*, 108 AFTR 2d 2011-6340. US District Court, Eastern District of Texas.
- US filed for Summary Judgment. Court denied.
- Court gave good explanation of what is needed for reasonable cause analysis regarding Form 5471.

REASONABLE CAUSE

- *Congdon* case continued.
- Court refers to IRM and other sections of Code.
- “The elements that must be present to constitute reasonable cause are a question of law, but whether those elements are present in a given situation is a question of fact.”

REASONABLE CAUSE

- *Congdon* case continued.
- “However, reasonable cause may be established if the taxpayer shows ignorance of the law in conjunction with other facts and circumstances.”
- “Generally, the most important factor in determining whether the taxpayer has reasonable cause and acted in good faith is the extent of the taxpayer’s effort to report the proper tax liability.”

REASONABLE CAUSE

- *Congdon* case continued.
- “Failure to file because of an erroneous belief that no return is required to be filed is not reasonable cause.”
- “...a taxpayer’s sophistication with respect to tax laws, at the time the return was filed, is relevant in determining whether the taxpayer acted with reasonable cause.”

REASONABLE CAUSE

- Other factors need to be looked at.
- Filing history. IDRS work.
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**Reasonable Cause &
Hazards of Litigation
– IRC 6662 Penalty**

Overview of Issue

Appeals consideration of reasonable cause and litigating hazards for the purpose of fair and consistent administration of the IRC 6662 accuracy-related penalty.

Reminder

Penalties exist to encourage voluntary compliance as by supporting the standards of behavior required by the Internal Revenue Code. Policy Statement 20-1. [IRM 1.2.20.1.1](#)

- Defining standards of compliant behavior
- Defining consequences for noncompliance
- Providing monetary sanctions against taxpayers who do not meet the standard.

Reasonable Cause (Legal aspects)

- ▶ Understanding [IRC 6662](#)
- ▶ Understanding [Treasury Regulation 1.6662-1](#)
- ▶ Understanding applicable Court Decisions

For all links – Right Click Open Hyperlink
See Slide 56 & 57 for additional resource links

Understanding IRC 6662 and the applicable Treasury Regulations

- ▶ A 20-percent penalty is imposed on the portion of a tax underpayment that is due to negligence, any substantial understatement of income tax, or inaccuracies resulting from certain valuation understatements.
- ▶ The 20-percent accuracy related penalty may be waived if the taxpayer can establish reasonable cause and that the taxpayer acted in good faith.

Negligence

- ▶ "Negligence" includes any failure to make a reasonable attempt to comply with the provisions of the Code, or to exercise ordinary and reasonable care in the preparation of a tax return. [IRC 6662\(c\)](#); [Treas Reg 1.6662-3\(b\)\(3\)](#)
- ▶ Negligence also includes any failure by the taxpayer to keep adequate books and records or to substantiate items properly. [Treas Reg §1.6662-3\(b\)\(1\)](#)

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According to regulations, negligence is strongly indicated where:

(1) a taxpayer fails to include on an income tax return an amount of income shown on an information return;

(2) a taxpayer fails to make a reasonable attempt to ascertain the correctness of a deduction, credit or exclusion on a return that would seem to a reasonable and prudent person to be "too good to be true" under the circumstances;

(3) a partner fails to comply with the requirements of [IRC 6222](#), which requires that a partner treat partnership items on its return in a manner that is consistent with the treatment of such items on the partnership return (or notify the Secretary of the inconsistency); and

(4) a shareholder fails to comply with the requirements of [IRC 6037](#), which requires that an S corporation shareholder treat subchapter S items on its return in a manner that is consistent with the treatment of such items on the corporation's return (or notify the Secretary of the inconsistency).³

Substantial Understatement

A substantial understatement exists if the understatement of income tax exceeds the greater of :

- ▶ 10 percent of the tax required to be shown on the return or
- ▶ \$5,000 (\$10,000 for corporations other than S corporations and personal holding companies). IRC 6662(d)(1)

Treas Reg [1.6662-4](#).

Valuation Understatements

A valuation misstatement exists when the value or basis of property claimed on any income tax return is 150 percent or more of the property's correct value or basis. The penalty applies when the tax attributable to the valuation overstatement exceeds \$5,000 (\$10,000 in the case of corporations other than S corporations or personal holding companies).

IRC 6662(e)(2); Treas Reg [1.6662-5\(e\)\(3\)](#).

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The substantial valuation misstatement penalty applies most commonly in cases in which (1) the taxpayer attempts to inflate a charitable contribution deduction of property by overstating the property's value or (2) in order to inflate cost recovery deductions, the taxpayer overstates the adjusted basis of depreciable property.

Reasonable Cause

No accuracy-related penalty is imposed on an underpayment if it is shown that there was a reasonable cause and that the taxpayer acted in good faith. [IRC 6664\(c\)](#)

Treas Reg [1.6664-4\(a\)](#)

Court Decisions

If there is case law that clearly applies to the fact pattern of an issue you are considering, and if all of the court decisions reach the same conclusion, you will have little difficulty in reaching a determination on the issue.

However, the cases received in Appeals don't always have issues with well-defined legal precedent. You need to know what weight to apply to the decisions of the various courts when evaluating the law that applies to an issue.

Court Cases (cont.)

Cases decided at a higher level in the judicial hierarchy should be given greater deference than the decisions of the lower courts. Absent a U. S. Supreme Court decision that is on-point with your issue, the following guidelines should be considered:

Court Cases (more.)

- ▶ A trial court decision, such as a District Court or Tax Court, carries less weight than the Court of Appeals
- ▶ A Court of Appeals or District Court decision in the taxpayer's specific jurisdiction has greater authority than the same court in another jurisdiction
- ▶ Various factors to consider on Older cases – a declining degree of importance due to age or are they are continuously cited as authority in later cases?

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(For bullet #1) Likewise, the decision of a court that does not generally hear tax cases, such as a Bankruptcy Court, may have less weight than a decision from a court that regularly deals with tax issues.

(For bullet #3) unless they are continuously cited as authority in later cases

Reasonable Cause – Items to Consider

Ordinary business care and prudence, consider the following:

- ▶ What happened and when did it happen?
- ▶ During the period of time the taxpayer was non-compliant, what facts and circumstances prevented the taxpayer from complying with the law?
- ▶ How did the facts and circumstances result in the taxpayer not complying?
- ▶ How did the taxpayer handle the remainder of their affairs during this time?
- ▶ Once the facts and circumstances changed, what attempt did the taxpayer make to comply?
- ▶ IRM 20.1.1.3.2(5)

Ordinary Business Care and Prudence

Ordinary business care and prudence includes making provisions for business obligations to be met when reasonably foreseeable events occur.

- ▶ A taxpayer may establish reasonable cause by providing facts and circumstances showing that he or she exercised ordinary business care and prudence (taking that degree of care that a reasonably prudent person would exercise), but nevertheless were unable to comply with the law.
- ▶ [IRM 20.1.1.3.2.2](#)

Ordinary Business Care and Prudence – Taxpayer Explanation

The taxpayer's reason should address the penalty imposed. To show reasonable cause, the dates and explanations should clearly correspond with events on which the penalties are based. If the dates and explanations do not correspond to the events on which the penalties are based, request additional information from the taxpayer that may clarify the explanation.

Ordinary Business Care and Prudence – Length of Time

Length of Time: Consider the length of time between the event cited as a reason for the noncompliance and subsequent compliance.

Consider:

- ▶ when the act was required by law,
- ▶ the period of time during which the taxpayer was unable to comply with the law due to circumstances beyond the taxpayer's control, and
- ▶ when the taxpayer complied with the law.

Circumstances Beyond the Taxpayer's Control

Consider whether or not the taxpayer could have anticipated the event that caused the noncompliance.

Reasonable cause is **generally** established when the taxpayer exercises ordinary business care and prudence, but, due to circumstances beyond the taxpayer's control, the taxpayer was unable to timely meet the tax obligation. The taxpayer's obligation to meet the tax law requirements is ongoing. Ordinary business care and prudence requires that the taxpayer continue to attempt to meet the requirements, even though late.

Compliance History

Check the preceding tax years (at least three) for patterns and the taxpayer's overall compliance history. The same penalty, previously assessed or abated, may indicate that the taxpayer is not exercising ordinary business care – especially if a prior accuracy penalty is present. Compliance is one more factor to consider. Since a first time Accuracy penalty does not by itself establish reasonable cause – facts and circumstances of the case itself should be the focus of the Accuracy penalty determination.

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One school of thought is a taxpayer's prior compliance history should be given much consideration when dealing with accuracy penalties. Accuracy penalties are generally only proposed in an audit, and a small percentage of taxpayers are audited each year. The fact that a taxpayer may have never faced a prior accuracy penalty might simply be because they've never been audited before. Therefore minimal weight should be given to the fact that a taxpayer may have never had a 6662 penalty imposed in the past. The facts and circumstances of the case itself should be the focus of the determination.

Unable to Obtain Records

If the taxpayer was unable to obtain records necessary to comply with a tax obligation, the taxpayer may or may not be able to establish reasonable cause. Reasonable cause may be established if the **taxpayer exercised ordinary business care and prudence, but due to circumstances beyond the taxpayer's control, he or she was unable to comply.**

[IRM 20.1.1.3.2.2.3](#)

Unable to Obtain Records – Items to Consider

Information to consider when evaluating such a request includes, but is not limited to, an explanation as to the following:

- ▶ Why the records were needed to comply.
- ▶ Why the records were unavailable and what steps were taken to secure the records.
- ▶ When and how the taxpayer became aware that he or she did not have the necessary records.
- ▶ If other means were explored to secure needed information.
- ▶ Why the taxpayer did not estimate the information.
- ▶ If the taxpayer contacted the IRS for instructions on what to do about missing information.
- ▶ If the taxpayer promptly complied once the missing information was received.
- ▶ Supporting documentation such as copies of letters written and responses received in an effort to get the needed information.

Mistake

The taxpayer may try to establish reasonable cause by claiming that a mistake was made. Generally, this is **not** in keeping with the **ordinary business care and prudence standard** and does not provide a basis for reasonable cause.

[IRM 20.1.1.3.2.2.4](#)

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However, the reason for the mistake may be a supporting factor if additional facts and circumstances support the determination that the taxpayer exercised ordinary business care and prudence but nevertheless was unable to comply within the prescribed time.

Mistake – Items to Consider

Information to consider when evaluating a request for an abatement or non-assertion of a penalty based on a mistake or a claim of ignorance of the law includes, but is not limited to the following:

- ▶ When and how the taxpayer became aware of the mistake.
- ▶ The extent to which the taxpayer corrected the mistake.
- ▶ The relationship between the taxpayer and the subordinate (if the taxpayer delegated the duty).
- ▶ If the taxpayer took timely steps to correct the failure after it was discovered.
- ▶ The supporting documentation.

Ignorance of the law

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:

- ▶ The taxpayer's education.
- ▶ If the taxpayer has previously been subject to the tax.
- ▶ If the taxpayer has been penalized before.
- ▶ If there were recent changes in the tax forms or law which a taxpayer could not reasonably be expected to know.
- ▶ The level of complexity of a tax or compliance issue.
- ▶ [IRM 20.1.1.3.2.2.6](#)

Ignorance of the law (cont.)

The taxpayer may have reasonable cause for noncompliance due to ignorance of the law if the following are true:

- ▶ A reasonable and good faith effort was made to comply with the law, or
- ▶ The taxpayer was unaware of a requirement and could not reasonably be expected to know of the requirement.

Experience, Knowledge, Sophistication, and Education of Taxpayer

- ▶ Circumstances that may suggest reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of the facts, including the experience, knowledge, sophistication and education of the taxpayer. The taxpayer's mental and physical condition, as well as sophistication with respect to the tax laws at the time the return was filed, are relevant in deciding whether the taxpayer acted with reasonable cause.
- ▶ If the taxpayer is misguided and unsophisticated in tax law, but acts in good faith, a penalty is not warranted.

Reasonable Cause and Good Faith

Case Study: Cox v. Commissioner, T.C. Memo 2005-288

- ▶ Is the IRC 6662 accuracy-related penalty applicable?
- ▶ See Notes below – for case facts and decision.

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The crucial fact here is that the Coxes relied in good faith on Spiller to correctly prepare their tax return based on the financial records and receipts they gave him. This was reasonable -- he was a former IRS auditor, and had competently done their taxes in the past before his evidently rapid decline and death. While a taxpayer cannot hide behind a tax preparer or adviser, we have often held that a taxpayer who supplies his preparer with accurate information relating to the return is not negligent in relying upon the preparer's advice. *Kurzet v. Commissioner*, T.C. Memo 1997-54, *affd.*, *revd.*, and remanded on other issues, 222 F.3d 830 (10th Cir. 2000). We do not fault the Coxes for the errors [*11] on their return when the mistakes stemmed from their accountant's lack of professional care. *Reinhardt v. Commissioner*, T.C. Memo 1993-397 (no negligence when an "incorrect return is the result of the preparer's mistakes"). We also take into account the Coxes' educational and business experience. See *Pratt v. Comm'r*, T.C. Memo 2002-279. The trial showed that Cox, though gifted in his field, knew little of accounting. Such men should especially be able to rely on a preparer if they give him their business records, holding no information back, as we specifically find that he did. Given Cox's genuine lack of knowledge of accounting, we do not construe his actions as constituting negligence or disregard of tax law. See *Neely v. Commissioner*, 85 T.C. 934, 947-48 (1985)

Reasonable Cause and Good Faith Example 1

C, an individual, sought advice from D, a friend who was not a tax professional, as to how C might reduce his Federal tax obligations. D advised C that, for a nominal investment in Corporation X, D had received certain tax benefits which virtually eliminated D's Federal tax liability. D also named other investors who had received similar benefits. Without further inquiry, C invested in X and claimed the benefits that he had been assured by D were due him. In this case, C did not make any good faith attempt to ascertain the correctness of what D had advised him concerning his tax matters, and is not considered to have reasonable cause for the underpayment attributable to the benefits claimed.

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Example 1 and 2 taken from the regulations 1.6664-4

Reasonable Cause and Good Faith Example 2

E, an individual, worked for Company X doing odd jobs and filling in for other employees when necessary. E worked irregular hours and was paid by the hour. The amount of E's pay check differed from week to week. The Form W-2 furnished to E reflected wages for 1990 in the amount of \$29,729. It did not, however, include compensation of \$1,467 paid for some hours E worked. Relying on the Form W-2, E filed a return reporting wages of \$29,729. E had no reason to know that the amount reported on the Form W-2 was incorrect. Under the circumstances, E is considered to have acted in good faith in relying on the Form W-2 and to have reasonable cause for the underpayment attributable to the unreported wages.

Hazards of Litigation

A “hazards” settlement is an intermediate resolution of an issue based upon the fact that there is substantial uncertainty in the event of litigation as to how the courts would interpret and apply the law or as to what facts the courts would find. Generally, this means that Appeals will settle an issue for a reduced amount, on a basis less than a 100% concession or sustention.

Litigating Hazard

A litigating hazard is a substantial uncertainty in the event of litigation as to:

- ▶ how courts would interpret and apply the law;
- ▶ what facts the court would find; or
- ▶ the admissibility of or weight that would be given to a specific item of evidence.

Litigating hazards will generally fall into three categories: factual, evidentiary or legal.

Hazards of Litigation (ID the facts)

The first step in evaluating an issue is to identify the controlling facts. The controlling facts are those which are necessary to establish the case for either the Service or the taxpayer. You must consider the admissibility, credibility, and probative or substantiating value of the evidence that is available.

Hazards of Litigation (Examples)

Some examples of factual and evidentiary hazards are:

- ▶ All the facts of the case may not be known. Even after full development, there may be some dispute as to certain facts, and the weight they should be given.
- ▶ Lack of evidence to support allegations asserted in the file.
- ▶ Inability to obtain required evidence to support the issue or the inadmissibility of evidence.
- ▶ The availability of witnesses.
- ▶ The credibility of witnesses.

Taxpayer's Testimony

Many times, the most important witness is the taxpayer. Even though the testimony may be self-serving, if it is credible, it will be given substantial weight if there is no contradictory evidence. It is important not to focus on the fact that the testimony is self-serving, but instead to consider whether the taxpayer's statements are credible.

Taxpayer's Testimony – Items to Consider

Specific questions include:

- ▶ Has the witness given contradictory statements?
- ▶ Does other evidence support the testimony?
- ▶ Is the testimony plausible, credible, and believable?
- ▶ Is the witness articulate, sincere, calm, and self-assured, or just the opposite?
- ▶ Is the witness biased?
- ▶ Is the witness dishonest; does he or she have a reputation that precludes belief?
- ▶ Does the witness have a bad memory?

Inconsistent or incredible Testimony

A taxpayer's testimony is competent evidence in most cases, and may well carry the day for the taxpayer. More often than not, the court does believe the uncontroverted testimony of taxpayers if not inherently inconsistent or incredible. See, for example, Stonecipher v. Commissioner, T.C. Memo 1988-41

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In *Stonecipher v. Commissioner*, T.C. Memo 1988-41, the taxpayers' explanation was sufficient to rebut the Commissioner's allegation of fraud, and *Fields v. Commissioner*, TC Memo 1999-408, in which the Tax Court determined that although the Commissioner's methodology in computing income from bingo games was reasonable, on the basis of the taxpayers' testimony, and that of others, all income earned went to the sponsoring organizations.

Testimony of the Compliance Officer

In developing your settlement position, you should rely on the available evidence, and not on statements from the Compliance Officer, whose testimony, even if admissible, would likely be limited in scope.

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Generally, the Tax Court will not look behind a deficiency notice to examine the evidence used, or the propriety of the Service's motives, or of the administrative policy or procedure involved in making a determination. The underlying rationale is the fact that a determination by the Tax Court must be based on the merits of the case and not any previous record developed at the administrative level.

Legal Hazards

There are a number of factors that you should consider when evaluating the legal hazards for any given issue. Some of these factors are:

- ▶ Doubt as to Legal Conclusion
- ▶ Evaluation of Court Cases
- ▶ Action on Decision
- ▶ Ability to Meet the Burden of Proof
- ▶ Ability to Go Forward With the Evidence

Doubt as to Legal Conclusion

- ▶ A hazard exists in an issue where there is an absence of legal precedent. From a practical standpoint, the stronger the Government's evidence in this type of situation the better, since the first several cases tried on a given issue will usually set the trend for future trials.

Lack of Legal Precedents

When faced with situations where there is an absence of legal precedent, you must review, evaluate, and apply the law to the facts and evidence in your issue. Some key legal issue questions are:

- ▶ Is the law clear or ambiguous?
- ▶ Does the legislative history support the IRS position?
- ▶ What did Congress intend?

Legal Precedents – Items to Consider

When you encounter a conflict between courts, you will need to consider:

- ▶ What weight to afford each decision, keeping in mind where the court sits in the judicial hierarchy.
- ▶ Whether your case would fall under that court's jurisdiction.
- ▶ How closely the facts of the decided case fit the facts and circumstances of your case.
- ▶ Whether the rationale of the court is reasonable and has generally gained the favor of other courts over the conflicting decision.

Action on Decision

Check to see whether an Action on Decision (AOD) was published by the IRS. If a court decision is adverse to the Service's position, the rationale in the Action on Decision may be useful in evaluating your issue.

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If there is a conflict between the Circuit Courts of Appeal, check with Area Counsel to determine the amount of litigation activity in other circuits and the likelihood of the Supreme Court resolving the conflicting positions in the near future.

Burden of Proof

Generally, the taxpayer has the burden of proof. The burden is met by a preponderance of the evidence, except as otherwise provided by statute or determined by the Court.

- ▶ If a penalty was proposed, Congress believed that during court proceedings the Service should not be able to rest on the presumption of correctness if it did not provide any evidence relating to the penalty.

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Some exceptions to this general rule are: civil fraud penalties (where the Government has the burden to present clear and convincing evidence), transferee liability, and accumulated earnings tax cases (which require the Government to present a preponderance of the evidence).

Evidence

If an issue is litigated, the taxpayer will attempt to carry his or her burden of proof with the submission of documentary evidence, witness testimony, and legal arguments. The Government's ability to go forward with the issue will depend upon its ability to effectively impeach, and/or discredit the taxpayer's documentary evidence and witness testimony, and rebut the taxpayer's legal arguments.

Rating and weighing factors

- ▶ Consider all the factual hazards (or factors)
- ▶ Rate those factors (for the government, or for the taxpayer, neutral)
- ▶ Weigh those factors, considering the value of the evidence in determining settlement ranges

Decision making factors

Consider all the factual hazards (or factors):
Once you complete your review of the facts, evidence, testimony, legal arguments and an analysis of case law, you are ready to determine a settlement range.

There is no simple formula that can be used to determine an acceptable settlement range for every case you handle. It takes the facts and applicable law for your case, and most importantly, your experience and judgment, to arrive at an acceptable settlement.

Rating factors

Rate those factors (for the government, or for the taxpayer, neutral): Although Appeals employees may differ in their approach to evaluating the hazards of litigation for an issue, most try to work through a mental process that considers the following factors once they have all of the pieces of the settlement puzzle assembled:

Rate the Factors (full concession or 50/50)

- ▶ Does the evaluation of the issue fall into one of two extremes, *i.e.*, does either the Government or the taxpayers have such a strong case that one side should fully concede the issue?
- ▶ If there is merit to the positions of both parties so that neither party should fully concede the issue? The next step might be to ask if there is equal merit to the respective positions. If so, then a 50/50 settlement of the issue would be appropriate.

Rate the factors (evaluate relative strengths)

- ▶ If there is not equal merit to the positions of both parties, the next step might be to ask which side has the stronger position and, relatively speaking, how strong is it. From this point, determine an appropriate settlement range for the issue (60/40, 70/30, etc.) that reflects your evaluation.

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It is important to keep in mind – there is seldom an exact answer to any hazards settlement question. Rather, there is a range of possible settlements that would likely result in a fair and reasonable disposition of the case. This range may vary by as much as 10% or more depending on the specifics of the case.

Hazards of Litigation (Weigh the Factors)

Weigh those factors, considering the value of the evidence in determining settlement ranges:

Once you have identified what factors in your case are relevant you will rate the factors.

Rating the factors involves identifying if the relevant factor favors the government, favors the taxpayer, or is neutral.

Weigh the Factors – Items to Consider

- ▶ When rating a factor, do not let other factors influence your rating.
- ▶ Not all factors carry the same weight. The weight you apply essentially translates to the relevance of the factor.

▶ (b)(7)(E)

Determining a Settlement Range

After identifying the factors, they should be rated as either in favor of the taxpayer or in favor of the government. For example, a case involves ten factors, overall. Of the factors, four favor the taxpayer and six favor the government. A settlement, recommending relief of 40% of the penalty, may be appropriate if assuming all of the factors are the same.

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If any particular factor has more relevance or weighs more heavily than the other factors, it may influence your ratio differently.

List of Resources

- ▶ [IRC 6662](#) – Accuracy Penalty
- ▶ [IRC 6663](#) – Civil Fraud Penalty
- ▶ [IRC 6664](#) – Reasonable Cause Exception
- ▶ [Treas Reg 1.6662-1](#) – Overview Accuracy Penalty
- ▶ [1.6662-2](#) – General and amount of Penalty
- ▶ [1.6662-3](#) – Negligence
- ▶ [1.6662-4](#) – Substantial Understatement
- ▶ [1.6662-5](#) – Valuation Misstatement
- ▶ [1.6664-4](#) – Reasonable Cause Exception
- ▶ [IRM 8.11](#) – Penalties worked in Appeals
- ▶ [IRM 20.1](#) – Penalty Handbook

List of Resources in ApEx

- ▶ [ApEx Resource – Penalty Cases – Reasonable Cause](#)
- ▶ [ApEx Resource – Penalty Court Cases](#)
- ▶ [ApEx Resource – Hazards of Litigation Training Guide](#)
- ▶ [Penalties – Accuracy and Delinquency Presentation](#)

Penalties in Appeals – Reasonable Cause

Penalties in our Tax system

- Penalties are an instrumental function of promoting voluntary tax compliance. Enhancing voluntary compliance supports the Service's mission.
- Tax penalties serve the critical function of defining tax compliance. Before a tax system can figure out how to promote compliance, it must first determine what conduct will count as compliance.
- It's a self-assessment system where the concept of tax compliance defines the taxpayer's best effort to assess their tax liabilities correctly. Generally, people want to conform to laws and standards of a society – cooperating and respecting legitimate obligations are important.
- The amount, or rate, of tax penalties impose standards of conduct on taxpayers and tax practitioners. The goal is the cost of compliance is less than the penalty imposed. Therefore, it's equitable to those who comply that not conforming to tax law will have a cost.

The IRS is required by law to charge penalties when taxpayers fail to file returns, make deposits, pay taxes timely or in sufficient amounts, or provide required information. Unlike work coming to Appeals as the result of IRS compliance or enforcement activities, most penalty appeals originate from the original processing of a filed tax or information return. In most circumstances a penalty is generated by the computer upon processing and a notice assessing the penalty is sent to the taxpayer. Penalty appeal cases involve business accounts and individual accounts – see law listed below.

Penalty Relief Categories:

- Statutory Exception
- Administrative Waiver
- Correction of a Service Error
- Reasonable Cause

In Appeals, recommendations for abatement are mostly based on review of the information provided by the taxpayer relative to the Reasonable Cause criteria in the IRM. A taxpayer may fail to comply with tax law due to circumstances beyond the taxpayer's control – depending on established facts and circumstances. However, settlements can be based on other determinations - hazards of litigation and mitigating circumstances – see links below for Penalty Court Case documents. Relief from penalties due to statutory exception, administrative waiver or correction of a Service error should be granted at the Compliance level.

The importance of Appeals penalties consideration is paramount – because further recourse for the taxpayer beyond Appeals requires the taxpayer to pay the penalty and file a claim. In most cases because further recourse in the courts is often seen as unrealistic, impractical, or economically unfeasible for the taxpayer. The Tax Court is unavailable for many penalties on their own – taxpayers need to file with District Court or Court of Appeals. Therefore, Appeals represents the last real opportunity for the taxpayer to resolve the dispute.

The Penalty relief material for Appeals is generally focused on reasonable cause and hazards of litigation. This material details the law and IRM for an understanding of penalties and reasonable cause criteria. The Penalty Court case documents goes deeper into court citations for a working knowledge of penalty cases in court history and a resource if needed in Penalty cases – see links below.

Our legal system is based upon common law. In common law, a precedent or authority is a legal case that establishes a principle or rule. This principle or rule is then used by the court or other judicial bodies use when deciding later cases with similar issues or facts. Therefore, court decisions have a huge impact on how Appeals works penalty cases.

Penalties in Appeals – Reasonable Cause

Penalty Abatement

Issue: Does the Taxpayer qualify for Reasonable Cause Penalty Abatement

Reasonable Cause [IRM 8.11.1.1.7.1](#) and [IRM 20.1.1.3.2](#)

Reasonable cause is based on all the facts and circumstances in each situation and allows us to provide relief from a penalty that would otherwise be assessed. Reasonable cause relief is generally granted when the taxpayer exercised ordinary business care and prudence in determining his or her tax obligations but nevertheless failed to comply with those obligations.

(1) Penalty cases handled in Appeals may involve complex and questionable reasonable cause issues.

(2) The following questions should be used to determine if the taxpayer has established reasonable cause and should be considered in your final determination.

Your decision must be clearly documented in the ACM and the facts and circumstances must support the decision:

- a. Do the taxpayer's explanations directly relate to the penalty that was assessed?
- b. Do the dates and times coincide with the taxpayer's explanation?
- c. Could the noncompliance have been anticipated and/or prevented?
- d. Did the taxpayer make an honest mistake?
- e. Has the taxpayer provided sufficient detail (dates, relationships, documents) to determine if ordinary business care and prudence was exercised?
- f. Is the taxpayer an individual, third party such as a reporting agent, accountant or lawyer?
- g. Is there a history of the taxpayer being assessed the same penalty?
- h. Were there prior abatements of the same or similar penalties?

Ordinary Business Care and Prudence

[IRM 20.1.1.3.2.2](#)

1. Ordinary business care and prudence includes making provisions for business obligations to be met when reasonably foreseeable events occur. A taxpayer may establish reasonable cause by providing facts and circumstances showing that he or she exercised ordinary business care and prudence (taking that degree of care that a reasonably prudent person would exercise), but nevertheless were unable to comply with the law.
2. In determining if the taxpayer exercised ordinary business care and prudence, review available information including the following:
 - a. **Taxpayer's Reason:** The taxpayer's reason should address the penalty imposed. To show reasonable cause, the dates and explanations should clearly correspond with events on which the penalties are based. If the dates and explanations do not correspond to the events on which the penalties are based, request additional information from the taxpayer that may clarify the explanation. See [IRM 20.1.1.3.2, Reasonable Cause](#).
 - b. **Compliance History:** Check the preceding tax years (at least three) for payment patterns and the taxpayer's overall compliance history. The same penalty, previously assessed or abated, may indicate that the taxpayer is not exercising ordinary business care. If this is the taxpayer's first incident of noncompliant behavior, weigh this factor with other reasons the taxpayer gives

Penalties in Appeals – Reasonable Cause

for reasonable cause, since a first- time failure to comply does not by itself establish reasonable cause.

- c. **Length of Time:** Consider the length of time between the event cited as a reason for the noncompliance and subsequent compliance. See IRM 20.1.1.3.2, *Reasonable Cause*. Consider: (1) when the act was required by law, (2) the period of time during which the taxpayer was unable to comply with the law due to circumstances beyond the taxpayer's control, and (3) when the taxpayer complied with the law.
- d. **Circumstances beyond the Taxpayer's Control:** Consider whether or not the taxpayer could have anticipated the event that caused the noncompliance. Reasonable cause is **generally** established when the taxpayer exercises ordinary business care and prudence, but, due to circumstances beyond the taxpayer's control, the taxpayer was unable to timely meet the tax obligation. The taxpayer's obligation to meet the tax law requirements is ongoing. Ordinary business care and prudence requires that the taxpayer continue to attempt to meet the requirements, even though late.

What to Verify

Does the request meet Oral or unsigned request for penalty relief or is a written signed statement required? IRM 20.1.1.3.1

1. If an unsigned or oral requests is received for penalty relief for the failure to file (FTF), failure to pay (FTP) and/or failure to deposit (FTD) penalties may be considered if the following is true:
 - a. The request is received either orally or in writing, but is unsigned
 - b. The request is received from the taxpayer, the taxpayer's authorized representative or a third party
 - c. (b)(7)(E)
 - d. Reasonable cause criterion is met

If the above criteria are not met a written signed statement must be provided for consideration.

Possible reasons for reasonable cause abatement per the IRM

Death or Serious Illness or unavoidable absence

IRM 20.1.1.3.2.2.1

If there was a death or serious illness or unavoidable absence of a taxpayer or a close family member there may be reasonable cause for a waiver of penalties. The IRS will consider whether someone else is authorized to meet the obligation the relationship of the parties involved, date of death, duration and severity of illness, reason for absence, explanations of how the event prevented compliance and then whether other business obligations were impaired and whether the tax duties were promptly attended after death, illness or absence.

Fire Casualty Natural Disaster or other Disturbance

IRM 20.1.1.3.2.2.2

A fire, other casualty, National Disaster, or other disturbance can destroy tax records or prevent compliance. This may constitute reasonable cause if the taxpayer exercised ordinary business cares and prudence but was unable to comply due to circumstances beyond her or his control. Information the taxpayer should provide includes:

Penalties in Appeals – Reasonable Cause

- Date and description of the event
- An explanation of how the event prevented compliance
- Supporting documents such as a copy of the police, fire, or insurance report

Review the factors such as timing, effect on the taxpayer business, steps taken to comply with tax requirements, and whether the taxpayer complied when it became possible.

Unable to Obtain Records

IRM 20.1.1.3.2.2.3

The inability to obtain records necessary to comply with a tax requirement is evaluated to ascertain whether the taxpayer exercised ordinary business care or prudence but in spite of those efforts was unable to comply with tax requirements. The taxpayers should explain:

- Why the records were needed to comply
- Why the records are unavailable and what steps were taken to secure the records
- When and how they became aware that they did not have the records
- Other avenues explored to secure the information
- Why they did not estimate the information
- If they contacted IRS for instructions under the circumstances
- If they promptly complied once the missing information was received

Mistake was made

IRM 20.1.1.3.2.2.4

1. The taxpayer may try to establish reasonable cause by claiming that a mistake was made. Generally, this is **not** in keeping with the **ordinary business care and prudence standard** and does not provide a basis for reasonable cause.
2. However, the reason for the mistake may be a supporting factor if additional facts and circumstances support the determination that the taxpayer exercised ordinary business care and prudence but nevertheless was unable to comply within the prescribed time.
3. Information to consider when evaluating a request for an abatement or non-assertion of a penalty based on a mistake or a claim of ignorance of the law includes, but is not limited to the following:
 - When and how the taxpayer became aware of the mistake.
 - The extent to which the taxpayer corrected the mistake.
 - The relationship between the taxpayer and the subordinate (if the taxpayer delegated the duty).
 - If the taxpayer took timely steps to correct the failure after it was discovered.
 - The supporting documentation.

Erroneous advice or Reliance

IRM 20.1.1.3.3.4.2

When a taxpayer relies on erroneous oral advice of an IRS employee, penalties may be abated for reasonable cause. The taxpayer must show that the penalty did not result from a failure to provide the

Penalties in Appeals – Reasonable Cause

IRS with accurate and complete information and that the taxpayer exercised ordinary business care in relying on that advice.

Information to take into consideration includes:

- The taxpayers' prior history
 - Prior experience with the tax requirements
 - If the taxpayer could have relied on other tax information available such as forms and publications
- You are required to abate any portion of the penalty attributable to erroneous written advice furnished by the service employee acting in an official capacity.

Reliance on Professionals

IRM 20.1.1.3.3.4.3

As an initial matter, it's worth noting that the Supreme Court has held that:

When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exist, it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the attorney, to seek a "second opinion," or to try and monitor counsel on the provisions of the Code himself would nullify the very purpose of seeking advice in the first place "ordinary business care and prudence" do not demand such actions.

While it is true that actual reliance on the tax advice of an independent, competent professional may negate a finding of negligence, the reliance itself must be objectively reasonable in the sense that the taxpayer supplied the professional with all the necessary information to assess the tax matter and that the professional himself does not suffer from a conflict of interest or lack of expertise that the taxpayer knew of or should have known about.

A taxpayer is not responsible for his agent's mistake so long as he or she reasonably relied on the mistake in good faith. Thus, use of accountant alone does not constitute reasonable reliance on that professional's advice. The taxpayer must have provided the correct information to the accountant and the items incorrectly claimed or reported in the return were the result of the accountant's error.

To satisfy the requirement of ordinary care and prudence through reasonable reliance, the taxpayer must demonstrate that:

1. The advisor had sufficient expertise to justify reliance;
2. Necessary and accurate information was provided to the accountant

Ignorance of the Law

IRM 20.1.1.3.2.2.6

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
2. Their tax obligations. 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:

Penalties in Appeals – Reasonable Cause

- 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. Were there recent changes in the tax forms or law the taxpayer could not reasonably be expected to know.
 - e. The level of complexity of a tax or compliance issue.
3. Reasonable cause should never be presumed, even in cases where ignorance of the law is claimed.
 4. The taxpayer may have reasonable cause for noncompliance due to ignorance of the law if the following are true:
 - a. A reasonable and good faith effort was made to comply with the law, or
 - b. The taxpayer was unaware of a requirement and could not reasonably be expected to know of the requirement.

Forgetfulness

IRM 20.1.1.3.2.2.7

1. The taxpayer may try to establish reasonable cause by claiming forgetfulness or an oversight by the taxpayer, or another party, caused the noncompliance. Generally, this is **not** in keeping with the **ordinary business care and prudence standard** and does not provide a basis for reasonable cause. See IRM 20.1.1.3.2.2, *Ordinary Business Care and Prudence*.
2. If the taxpayer claims forgetfulness or an oversight by another party, consider the following:
 - a. Relying on another person to perform a required act is generally not sufficient for establishing reasonable cause.
 - b. **It is the taxpayer's responsibility to file a timely return and to make timely deposits or payments. This responsibility cannot be delegated.**

Negligence Penalty

IRM 20.1.5.7.1

1. Negligence includes any failure to make a reasonable attempt to comply with the provisions of the tax law, exercise ordinary and reasonable care in tax return preparation, or fails to keep adequate books and records.
2. Negligence is strongly suggested if a taxpayer fails to make a reasonable attempt to ascertain the correctness of a reported item "which would seem to a reasonable and prudent person to be 'too good to be true,' under the circumstances."

Example: The facts may establish that a taxpayer reported losses from a transaction that lacked economic substance or reported losses or deductions from assets with basis traceable to lease stripping transactions that would have seemed, to a reasonable and prudent person, to be "too good to be true." The accuracy-related penalty attributable to negligence may be applicable if the taxpayer failed to make a reasonable attempt to ascertain the correctness of the claimed losses or deductions by thoroughly investigating the bona fide economic or other relevant actual aspects of the transaction. Consultation with a tax advisor, regardless of the advisor's independence, is not, standing alone, conclusive evidence of a thorough investigation by the taxpayer. All relevant facts, including the nature of the tax investment, the independence of the tax advisor, the competence of the tax advisor, the quality of the opinion, and the sophistication of the taxpayer must be considered.

Penalties in Appeals – Reasonable Cause

This IRM discusses the estimated (ES) tax penalties outlined in the Internal Revenue Code (IRC) for both individual taxpayers under [IRC 6654](#) and corporate taxpayers under [IRC 6655](#).

Taxpayers are generally required to pay income tax as income is earned. This is accomplished via withholding from income or via estimated tax payments. Taxpayers who do not have sufficient amounts withheld and who fail to make estimated tax payments as required by law, may be assessed a penalty for underpayment of estimated tax.

IRM 20.1.3.2.7.1 - The penalty for underpayment of estimated tax cannot be removed or waived for reasonable cause alone.

IRM 20.1.3.2.7.2 - The criteria for available waivers (if any), as well as instructions for requesting a waiver, are contained in the instructions for the applicable penalty computation form ([Form 2210](#), [Form 2210-F](#), or [Form 2220](#)) for the given period.

Information Return Penalties

IRM 20.1.7 - *Information Return Penalties* - This section provides policy and procedures for the application of information return penalties per IRC 6721, IRC 6722, and IRC 6723. It also discusses reasonable cause criteria per IRC 6724.

Proposed penalty notices are generated from the information return data that is processed to the Payer Master File (PMF). Information return data includes:

- a. Form W-2, *Wage and Tax Statement*, which is filed with the Social Security Administration (SSA), and
- b. Form 1098 series, Form 1099 series, and other information documents that are filed with the IRS.

Systemically (computer) generated proposed penalty notices may include infractions identified for failure to timely file, failure to file on proper media, failure to file in the proper format, and/or missing and incorrect name/Tax Identification Number (TINs).

Penalty Laws

IRC 6651(a)(1) - Civil Tax Penalties, Failure to File states that in case of failure to file any return on the date prescribed, unless it is shown that such failure is due to reasonable cause and not due to willful neglect. The term "willful neglect" may be read as meaning a conscious, intentional failure or reckless indifference.

IRC 6651(a)(2) Civil Tax Penalties, Failure to Pay imposes an addition to tax for failure to pay the amount of tax shown on a taxpayer's Federal income tax return on or before the payment due date, unless such failure is due to reasonable cause and not willful neglect. A failure to pay will be considered due to reasonable cause if the taxpayer makes a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless unable to pay the tax or would suffer undue hardship if he paid on the due date.

Penalties in Appeals – Reasonable Cause

IRC 6656 (a) - Civil Tax Penalties, Failure to Deposit imposes a penalty for failing to timely make a required deposit of taxes in an authorized Government depository unless the failure was due to reasonable cause and not willful neglect.

IRC 6662 - Civil Tax Penalties, Accuracy penalties imposes a penalty on any portion of an underpayment of tax required to be shown on the return that is attributable to the taxpayer's negligence or disregard of rules or regulation. Negligence consists of any failure to make a reasonable attempt to comply with the provisions of the Internal Revenue Code and Disregard consists of any careless, reckless, or intentional disregard.

Treasury Regulation 301.6651-1 (c) While "reasonable cause" is not defined in the Code, the Treasury Regulation states that a showing of reasonable cause is made by demonstrating that the taxpayer "exercised ordinary business care and prudence and was nevertheless unable to" file or pay taxes on time." If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to a reasonable cause. A failure to pay will be considered to be due to reasonable cause to the extent that the taxpayer has made a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship if he paid on the due date. In determining whether the taxpayer was unable to pay the tax despite the exercise of ordinary business care and prudence in providing for payment of his tax liability, consideration will be given to all the facts and circumstances of the taxpayer's financial situation.

IRC 6721 – Civil Tax Penalty – Information Return - The penalty will be imposed for any failure to file an information return with the Secretary on or before the required filing date, and any failure to include all the information required to be shown on the return or the inclusion of incorrect information.

IRC 6722 - Civil Tax Penalty – Information Return - The penalty will be imposed for Failure to furnish correct payee statements - any failure to furnish a payee statement on or before the date prescribed therefor to the person to whom such statement is required to be furnished, and any failure to include all the information required to be shown on a payee statement or the inclusion of incorrect information.

IRC 6723 - Civil Tax Penalty – Information Return - The penalty will be imposed for Failure to comply with other information reporting requirements. Penalties applied for incorrect or incomplete information – and a greater penalty for intentional disregard of reporting requirements.

IRC 6724 – Penalty Waiver - The penalty for a failure relating to an information reporting is waived if the failure is due to reasonable cause and is not due to willful neglect. The penalty is waived for reasonable cause only if the filer establishes that either - There are significant mitigating factors with respect to the failure, the failure arose from events beyond the filer's control. See **Treasury Regulation 301.6724-1** for details on relief criteria.

Additional Resources

[ApEx - Knowledge Management - Penalty Court Cases](#)

[ApEx - Knowledge Management - PENAPS Court Case Job Aid](#)

[ApEx - Knowledge Management - Penalty Appeals Reasonable Cause - PowerPoint Workshop](#)