

Challenging Tax Penalties

Strategies for the Practitioner

Eric L. Green, Esq.
Roger Nemeth, EA
Beverly Winsted, Esq.
Michael Sardar, Esq.

**GREEN &
SKLARZ** LLC

1

Agenda

1. Background and Issue with Penalties
2. Abatement Strategies
3. Civil Fraud Penalty

**GREEN &
SKLARZ** LLC

2

2

Penalty Policy Considerations

- Encourage voluntary compliance
- Conserve IRS resources
- Provide clear guidance to taxpayers and practitioners
- Ensure consistent and fair treatment of the issues
- Ensure noncompliant behavior is penalized

3

Qualifications for FTA

- Is the Tax Period 2001 or later?
- Is there a year with FTF, FTP, and or FTD?
- If the year with penalty is an SFR not replaced by an original return it does not qualify.
- Is the taxpayer compliant (last 6 years)?
- If the taxpayer owes, are they in an installment agreement?
- Have any penalties been assessed (Except Estimated Tax Penalty) in the prior 3 years? If yes, then disqualified unless those penalties were abated for reasonable cause or reversed.

4

Which Tax Returns Qualify for FTA?

Qualifies for FTA

- 1040 (Including Separate Assessments)
- 1120
- 1120-S
- 1065
- 940
- 941 (all other 94# series)
- 2290
- 720

Does NOT Qualify for FTA

- Form 706
- U.S. Estate Tax Return
- Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return
- Returns with an event-based filing requirement
- W&I Informational Returns
- Daily Delinquency Penalty (DDP)
- Employee Plans and Exempt Organization Penalties

GREEN & SKLARZ LLC **Note:** If an entity does not appear on this list you should apply and let the IRS advise if there is a reason it does not qualify for FTA.

5

5

Applying for FTA

- Phone Call
- Can call Practitioner Priority Service (PPS) or Automated Collections System (ACS) to make a verbal request for FTA
- Denial of a verbal request does not preclude making additional request over the phone or in writing.
- Written Request
- Can use form 843 or write a letter. Mail to the address on the most recent IRS notice OR processing center where taxpayer would file a paper return.
- Written requests should generally only be made once.

GREEN & SKLARZ LLC

6

6

How Reasonable Cause Abatements Impact FTA

- The Reasonable Cause Assister (RCA) will attempt to apply relief based on FTA before considering reasonable cause.
- Example if a request for Reasonable Cause is submitted by the taxpayer and that tax year qualifies for FTA the abatement is coded as an FTA.
- Any year in the 3 Year Lookback where the penalties are completely removed by reasonable cause abatement or reversal are considered a clean year.
- Clean Year = Does not disqualify the FTA request.

IRS IRM 13.1.24.6.1.1.2 (05-11-2018) First-Time Abate – Clean Compliance History

GREEN &
SKLARZ LLC

7

7

Critical Considerations

- FTA applies only to taxpayers not penalized for the three years prior
- Pull transcripts to confirm this!
- This case – “Has never owed anything”
- So far looks good....

IRS ACCOUNT STATUS DASHBOARD

Year	Return Filed	Filing Status	Extension Date	Lien Active	Collections Active	Examination Active	Assessed Balance	Accrued Balance	Transcript Date
2020	No	S					\$0.00	\$0.00	7/1/2020
2019	No	S					\$0.00	\$0.00	7/1/2020
2018	Original	MFJ	10/15/2019		4/22/2020	4/27/2020#	\$269,636.55	\$278,353.55	7/1/2020
2017	Original	MFJ	10/15/2018				\$0.00	\$0.00	7/1/2020
2016	Amended	MFJ	10/15/2017			Closed	\$0.00	\$0.00	7/1/2020
2015	Amended	MFJ	10/15/2016			Closed	\$0.00	\$0.00	7/1/2020
2014	Amended	MFJ	10/15/2015			Closed	\$0.00	\$0.00	7/1/2020
2013	Original	MFJ	10/15/2014				\$0.00	\$0.00	7/1/2020
2012	Original	MFJ	10/15/2013			Closed#	\$0.00	(\$0.73)	7/1/2020
2011	Original	MFJ	10/15/2012				\$0.00	\$0.00	7/1/2020
2010	Original	MFJ	10/15/2011			Closed	\$0.00	\$0.00	7/1/2020
2009	Original	MFJ	10/15/2010				\$0.00	\$0.00	7/1/2020
2008	Original	MFJ	10/15/2009	Removed			\$0.00	\$0.00	7/1/2020
2007	Original	MFJ	10/15/2008				\$0.00	\$0.00	7/1/2020
2006	Original	MFJ	10/15/2007				\$0.00	\$0.00	7/1/2020
2005	Original	MFJ	10/15/2006			ASED exp	\$0.00	\$0.00	7/1/2020
2004	Original	MFJ	10/15/2005				\$0.00	\$0.00	7/1/2020
2003	No	S					\$0.00	\$0.00	7/1/2020
2002	Original	MFJ	10/15/2003				\$0.00	\$0.00	7/1/2020
2001	Original	MFJ	10/15/2002				\$0.00	\$0.00	7/1/2020

GREEN &
SKLARZ LLC

8

8

Ooops.....

PENALTY AND INTEREST DASHBOARD

Year	Return Filed	FTA	PA	Penalties Failure to File	Penalties Failure to Pay	Accuracy Related Penalties	Accrued Penalty	Total Penalties*	Accrued Interest	Assessed Interest	Total Interest
2020	No						\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
2019	No						\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
2018	Original	N			\$147,801.15		\$0.00	\$147,801.15	\$8,717.03	\$121,835.40	\$130,552.43
2017	Original	N			\$63,295.94		\$0.00	\$63,295.94	\$0.00	\$48,928.11	\$48,928.11
2016	Amended	N	Y		\$93,701.63		\$0.00	\$93,701.63	\$0.00	\$52,011.86	\$52,011.86
2015	Amended	N	Y		\$18,314.56		\$0.00	\$18,314.56	\$0.00	\$74.80	\$74.80
2014	Amended	N	Y		\$62,065.80		\$0.00	\$62,065.80	\$0.00	(\$715.32)	(\$715.32)
2013	Original	N			\$21,256.24		\$0.00	\$21,256.24	\$0.00	\$9,829.42	\$9,829.42
2012	Original	N			\$21,156.48		\$0.00	\$21,156.48	(\$0.73)	\$9,694.70	\$9,693.97
2011	Original	N			\$22,879.56		\$0.00	\$22,879.56	\$0.00	\$10,798.64	\$10,798.64
2010	Original	N			\$13,672.62		\$0.00	\$13,672.62	\$0.00	\$7,838.33	\$7,838.33
2009	Original	N			\$9,100.33		\$0.00	\$9,100.33	\$0.00	\$5,867.29	\$5,867.29
2008	Original	N			\$49,332.13		\$0.00	\$49,332.13	\$0.00	\$28,906.92	\$28,906.92
2007	Original	N			\$58,617.62		\$0.00	\$58,617.62	\$0.00	\$40,252.35	\$40,252.35
2006	Original	N			\$14,215.04		\$0.00	\$14,215.04	\$0.00	\$13,972.08	\$13,972.08
2005	Original	N			\$1,928.49		\$0.00	\$1,928.49	\$0.00	\$2,514.92	\$2,514.92
2004	Original	N			\$6,166.78		\$0.00	\$6,166.78	\$0.00	\$6,290.80	\$6,290.80
2003	No						\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
2002	Original	N			\$15,795.96		\$0.00	\$15,795.96	\$0.00	\$11,335.74	\$11,335.74
2001	Original	?			\$15,528.70		\$0.00	\$15,528.70	\$0.00	\$15,165.28	\$15,165.28

Penalty Relief – IRS Notice 2022-36

Automatic Penalty Relief for Returns if filed by September 30, 2022

- Individual Income Tax Return (Forms 1040, 1040-C, 1040-NR, 1040-SR, etc.)
- Income Tax Return for Trusts and Estates (Form 1041)
- C Corporation Income Tax Return (Forms 1120, 1120-F, etc.)
- S Corporation Income Tax Return (Form 1120-S)
- Return of Partnership Income (Form 1065)
- Return of Private Foundations or Trusts Treated as Private Foundations (Forms 990-PF and 990-T)
- Information Return for U.S. Persons with Interests in Foreign Corporations (Form 5471)
- Information Return for U.S. Corporations with Foreign Owners (Form 5472)
- Information Return Related to Foreign Trusts and Estates (Forms 3520 and 3520-A)

The Notice also includes waivers of the penalty for failure to provide certain information to the IRS under IRC § 6721 (including Forms W-2 and W-3, as well as Forms 1094-C and 1095-C).

Qualified Amended Returns

- 26 U.S.C. 6664 and Treas. Reg. 1.6664-2(c)(3)
- Revenue Procedure 1994-69
- Eligibility – Triggering events
- IRS contact of taxpayer regarding a civil audit or criminal investigation
- IRS contact of any person subject to a promoter investigation where the taxpayer claimed a tax benefit on a return directly or indirectly
- IRS contact of a pass-through entity regarding a pass-through item
- IRS serves a John Doe summons where taxpayer or related entity is part of the group and related to an activity on taxpayer's return
- IRS announcement of settlement initiative regarding a listed transaction
- Effect – reduction or elimination of penalties

GREEN &
SKLARZ LLC

11

11

Strategies for Exam

- Build credibility with the examiner through cooperation, timeliness, and transparency
- Assume penalties will be imposed and build defense throughout the exam
- Seek to discuss the examiner's position and negotiate before it goes to 30-day letter



GREEN &
SKLARZ LLC

12

12

Strategies for Appeals

Appeals will not
simply concede

Use it as a bargaining
chip

Look at timing, taxpayer
history, specific
circumstances
Make sure the story fits!

13

Appeals

- Wont just concede because of the policy considerations
- Argue for conceding but request the abatement
- Make sure to point out factors that support your argument:
 - a. Client actually incurred the expense
 - b. Client hired a competent-appearing professional
 - c. Client provided all info and was attempting to comply
 - d. Client has a good history

14

Reasonable Cause - Appeals

- Does T/P explanation relate to the penalty?
- Do dates and times coincide?
- Could the non-compliance have been anticipated/prevented?
- Was it an honest mistake?
- Has T/P presented sufficient detail to determine if ordinary business care/prudence was used?

15

Reasonable Cause - Appeals



- Is the T/P a financial professional?
- What is the T/P's history with compliance?
- Has the T/P had this issue before?
- Have there been prior abatements?

16

Practice Tips

- Pull account transcripts to review history
- Charge the consult fee to review
- Get the documentation in advance and make sure it supports/lines up with the story

GREEN &
SKLARZ LLC

17

17

Reasonable Cause

Use Form 843

Request abatement

Document your case

Appeal (15 days)

Form 843 <small>Rev. August 2011</small> Department of the Treasury Internal Revenue Service		Claim for Refund and Request for Abatement <small>OMB No. 1545-0024</small>	
<small>▶ See separate instructions.</small>			
Use Form 843 if your claim or request involves:			
(a) a refund of one of the taxes (other than income taxes or an employer's claim for FICA tax, RRTA tax, or income tax withholding) or a fee, shown on line 3,			
(b) an abatement of FUTA tax or certain excise taxes, or			
(c) a refund or abatement of interest, penalties, or additions to tax for one of the reasons shown on line 5a.			
Do not use Form 843 if your claim or request involves:			
(a) an overpayment of income taxes or an employer's claim for FICA tax, RRTA tax, or income tax withholding (use the appropriate amended tax return),			
(b) a refund of excise taxes based on the nontaxable use or sale of fuels, or			
(c) an overpayment of excise taxes reported on Form(s) 11-C, 720, 730, or 2290.			
Name(s)		Your social security number	
Address (number, street, and room or suite no.)		Spouse's social security number	
City or town, state, and ZIP code		Employer identification number (EIN)	
Name and address shown on return if different from above		Daytime telephone number	
1 Period. Prepare a separate Form 843 for each tax period or fee year. From _____ to _____		2 Amount to be refunded or abated: \$ _____	
3 Type of tax or fee. Indicate the type of tax or fee to be refunded or abated or to which the interest, penalty, or addition to tax is related.			
<input type="checkbox"/> Employment <input type="checkbox"/> Estate <input type="checkbox"/> Gift <input type="checkbox"/> Excise <input type="checkbox"/> Income <input type="checkbox"/> Fee			
4 Type of penalty. If the claim or request involves a penalty, enter the Internal Revenue Code section on which the penalty is based (see instructions). IRC section: _____			
5a Interest, penalties, and additions to tax. Check the box that indicates your reason for the request for refund or abatement. (If none apply, go to line 6.)			
<input type="checkbox"/> Interest was assessed as a result of IRS errors or delays.			
<input type="checkbox"/> A penalty or addition to tax was the result of erroneous written advice from the IRS.			
<input type="checkbox"/> Reasonable cause or other reason allowed under the law (other than erroneous written advice) can be shown for not assessing a penalty or addition to tax.			
b Date(s) of payment(s) ▶ _____			
6 Original return. Indicate the type of fee or return, if any, filed to which the tax, interest, penalty, or addition to tax relates.			
<input type="checkbox"/> 706 <input type="checkbox"/> 709 <input type="checkbox"/> 940 <input type="checkbox"/> 941 <input type="checkbox"/> 943 <input type="checkbox"/> 945			
<input type="checkbox"/> 990-PF <input type="checkbox"/> 1040 <input type="checkbox"/> 1120 <input type="checkbox"/> 4720 <input type="checkbox"/> Other (specify) ▶ _____			
7 Explanation. Explain why you believe this claim or request should be allowed and show the computation of the amount shown on line 2. If you need more space, attach additional sheets.			

Signature. If you are filing Form 843 to request a refund or abatement relating to a joint return, both you and your spouse must sign the claim.

GREEN &
SKLARZ LLC

18

18

Reasonable Cause - Failure to File/Pay

- Must be due to reasonable cause and not willful neglect
- Multiple years are bad
- Medical problems are good
- Death is better
- Insufficient funds are not a defense unless can show hardship

19

Drafting the request

- Make the request – we are requesting penalty abatement for the following period(s)
- Factual background – how the client got here
- History – if a good history explain that
- Review the documentation – tab exhibits

20

Reasonable Cause: Reliance on Tax Advice



- Relying on a tax opinion by a tax advisor may serve as a defense to the accuracy related penalty
- Must be objectively reasonable
- Must be based upon all pertinent facts
- Advice must not be based upon unreasonable factual or legal assumptions
- Does not cover the filing of a return that is missed

GREEN &
SKLARZ LLC

21

21

Preparer/Promoter Penalties

- IRC §6694(a)—Unreasonable position
- IRC §6694(b)—Willful conduct or intentional or reckless disregard of rule/regs
- IRC §6695—Miscellaneous preparer misdeeds
- IRC §6695A—Appraisers
- IRC §6700—Promoters of abusive tax shelter

GREEN &
SKLARZ LLC

22

22

Preparer/Promoter Penalties

- IRC §6701—Aiding/abetting understatement of tax
- IRC §6702—Frivolous returns
- IRC §6707 and 6707A—Information returns for reportable/listed transactions
- IRC §6708—List of advisees
- IRC §6713—Improper disclosure/use of return info by preparer

23

Civil Fraud Penalty, Section 6663

I.R.C. § 6663:

Imposition of penalty

- If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment which is attributable to fraud.

a. Determination of portion attributable to fraud

- If the Secretary establishes that any portion of an underpayment is attributable to fraud, the entire underpayment shall be treated as attributable to fraud, except with respect to any portion of the underpayment which the taxpayer establishes (by a preponderance of the evidence) is not attributable to fraud.

24

Evidence of Fraud

Internal Revenue Manual- IRM Section 25.1.6.4 (06-10-2021) provides:

Since direct proof of fraudulent intent is rarely available, fraud must be proven by circumstantial evidence and reasonable inferences. Fraud generally involves one or more of the following elements:

- Deception;
- Misrepresentation of material facts;
- False or altered documents;
- Evasion (i.e., diversion or omission).

Common Indicators

- Understatement of income (e.g., omissions of specific items or entire sources of income, failure to report substantial amounts of income received);
- Fictitious or improper deductions (e.g., overstatement of deductions, personal items deducted as business expenses);
- Accounting irregularities (e.g., two sets of books, false entries on documents).

Common Indicators, cont.

- Obstructive actions of the taxpayer (e.g., false statements, destruction of records, transfer of assets, failure to cooperate with the examiner, concealment of assets);
- A consistent pattern over several years of underreporting taxable income; and
- Implausible or inconsistent explanations of behavior.

27

Common Indicators, cont.

- Engaging in illegal activities (e.g., drug dealing), or attempting to conceal illegal activities;
- Inadequate records;
- Dealing in cash, and;
- Failure to file returns.

28

Clark v. Comm'r, T.C.Memo 2021-114 (Sept. 28, 2021)

- Mr. Clark owned an auto shop.
- He substantially underreported his income on his tax returns.
- In these same years he filed financial statements with the bank to obtain lines of credit and also reported his finances during his divorce proceeds.
- When audited he did not provide IRS with bank records; he lied about his bank accounts; did not disclose or report his rental activity to the agent or on his tax returns; etc.



GREEN &
SKLARZ LLC

29

29

Applicable Defenses

- Badges not met;
- Burden not met (the government must provide clear and convincing evidence of fraud);
- IRS did not follow procedural requirements (IRS agent must present evidence of fraud, and penalty must be personally approved (in writing) by the immediate supervisor of the agent making the determination).



GREEN &
SKLARZ LLC

30

30

Collateral Estoppel

- IRM 25.1.6.5 (06-10-2021)
- Prevents a taxpayer that has been previously convicted of criminal tax evasion under IRC 7201, from asserting a defense to the civil fraud penalty.
- Taxpayer may still argue that the actual tax amount and the amount of the underpayment reported in the return due to fraud are incorrect.
- The doctrine of collateral estoppel applies only to the years for which the taxpayer has been convicted.
- Intent must be established for non-conviction years.

GREEN &
SKLARZ LLC

31

31

Questions?



GREEN &
SKLARZ LLC

32

32