

IRS NE Representation Conference

US Tax Court:

Considering Supervisory Approval and Reasonable Cause OUTLINE

November 17, 2022

Panelists

Honorable Diana Leyden, United States Tax Court, Washington, DC

Judge Leyden is Special Trial Judge with the United States Tax Court. Judge Leyden started in her current position in June 2016. Prior to becoming a Special Trial Judge, Judge Leyden served as the first Taxpayer Advocate for the New York City Department of Finance, creating that position and issuing the first Annual Report of the NYC Taxpayer Advocate in May 2016.

Frank Agostino, Esq., Agostino & Associates, Hackensack, NJ

Frank Agostino is the founder and president of Agostino & Associates, P.C. Prior to entering private practice, Mr. Agostino was an attorney with the Internal Revenue Service's District Counsel in Springfield, Illinois and Newark, New Jersey. He also served as a Special Assistant United States Attorney.

William Bogardus, Office of Chief Counsel, Internal revenue Service, Boston, MA

Mr. Bogardus is a Senior Counsel in the Hartford office of the Small Business/Self-Employed Division of the Office of Chief Counsel. For the past 20 years, Mr. Bogardus has primarily represented the IRS in litigation before the United States Tax Court, ranging from individual taxpayer issues, to collection matters, to \$100 million dollar tax shelters. Mr. Bogardus is currently a member of the Son of BOSS litigation cadre, the Section 41 Research Credit cadre, and was recently selected as a Syndicated Conservation Easement Lead Counsel.

Philip J. Wilson, CPA, Marcum, LLP, Costa Mesa, CA

Philip Wilson is office managing partner of Marcum's Costa Mesa, California, office and is leader of the Firm's national Tax Controversy group. Mr. Wilson has more than 30 years of CPA and business advisory experience, including experience as an IRS revenue agent.

Section 6751(b)

Approval of Penalty Assessment

I. What is Section 6751?

A. Section 6751(a) Penalty Notices and their requirements:

1. The Secretary shall include with each notice of penalty under this title information with respect to the name of the penalty, the section of this title under which the penalty is imposed, and a computation of the penalty.

B. Section 6751(b) Procedure for Penalty Assessment:

1. No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher-level official as the Secretary may designate.

C. Exceptions to Section 6751(b):

1. Any addition to tax under section 6651, 6654, 6655, or 6662 (but only with respect to an addition to tax by reason of subsection (b)(9) thereof); or any other penalty automatically calculated through electronic means.

D. Section 6751(c) What Constitutes a Penalty:

1. For this section, the term “penalty” includes any addition to tax or any additional amount.

II. When does Section 6751(b) apply?

- #### A. Any penalty, additional amount, or addition to the tax provided for in Title 26 of the Code is, or should be, subject to Section 6751(b)'s requirements.¹ Penalties can be determined in connection with a wide range of IRS returns or forms:

Code Section	Related Form	Nature of Penalty	Section 6751(b) Applicability and Authority
6662	1040 (Income)	Accuracy-Related	Yes, except for “substantial understatement” penalties because those have been

¹ The penalties, returns, and forms listed below are not an all-inclusive list but ensure that tax practitioners are familiar of the supervisory approval requirement for these common penalties.

Code Section	Related Form	Nature of Penalty	Section 6751(b) Applicability and Authority
			found to be electronically determined. See <i>Walquist v. Commissioner</i> , 152 T.C. 61 (2019).
6663	1040 (Income)	Civil Fraud	Yes. See <i>Minemyer v. Commissioner</i> , T.C. Memo. 2020-99.
6702	1040 (Income)	Frivolous Return	Yes. See <i>Kestin v. Commissioner</i> , 153 T.C. 14 (2019).
6676	1040/843 (Income/Refund)	Erroneous Refund or Credit	Yes. I.R.M., pt. 20.1.5.1 (08-31-21)
6672	940/941 (Employment)	Trust Fund Recovery	Yes. See <i>Chadwick v. Commissioner</i> , 154 T.C. 84 (January 21, 2020).
6038	5471/8865 (International)	Information Regarding Foreign Corporations & Partnerships	Yes. See I.R.M., pt. 20.1.9.3.1 (1-29-2021)
6038A	5472 (International)	Information Regarding Foreign Ownership of U.S. Corporation	Yes. See I.R.M., pt. 20.1.9.5.1(2) (1-29-2021)
6038B	926/8865 (International)	Information Regarding Foreign Corporations & Partnerships	Yes. See I.R.M., pt. 20.1.9.7.1 (1-29-2021)
6038D	8938 (International)	Information Regarding Foreign Financial Assets	Yes. See I.R.M., pt. 20.1.9.22.1 (1-29-21).

Code Section	Related Form	Nature of Penalty	Section 6751(b) Applicability and Authority
6039F	3520 (International)	Information Regarding Large Foreign Gifts	Yes. See I.R.M., pt. 20.1.9.13.1 (1-29-21).
6048/6677	3520/3520-A (International)	Information Regarding Foreign Trusts	Yes. See I.R.M., pt. 20.1.9.14.1(1-29-2021)
6114	8833 (International)	Information Regarding Treaty-Based Return Position	Yes. See I.R.M., pt. 20.1.9.20.1 (1-29-2021)
6011/6707A	1040 (Income)	Reportable Transaction	See <i>Laidlaw's Harley Davidson Sales, Inc. v. Commissioner</i> , 154 T.C. No. 4 (Jan. 16, 2020).

III. Rules and Regulations Regarding Section 6751(b)

A. Internal Revenue Manual

1. 20.1.1.2.3 (10-19-2020) Approval Prerequisite to Penalty Assessments:

- a) IRC 6751(a), Computation of Penalty Included in Notice, requires that each penalty notice include the name of the penalty, applicable IRC section, and a computation of the penalty.
- b) IRC 6751(b)(1), Approval of Assessment, states that in general, no penalty under the Internal Revenue Code shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate. At this time, the Secretary has not designated any higher level official to approve initial determinations.

2. 20.1.9.2(20) (01-29-2021):

- a) Approval—IRC 6751(b)(1) requires written approval of initial penalty determinations for most penalties covered in this IRM. The written approval should be obtained in a timely manner and follow

policy guidance set in IRM 20.1.1.2.3, Approval Prerequisite to Penalty Assessments, and IRM 20.1.1.2.3.1, Timing of Supervisory Approval. The Immediate Supervisor must approve the case control, sign the notice letters, and approve the penalty assessment by signing Form 8278. Personal approval of the supervisor is met with an original signature or a digital (e.g., through Adobe PDF) signature.

3. 8.11.5.1(7) (12-18-2015):

- a) Premature Referrals - An International penalty must be assessed before routing the case to Appeals. If the penalty is not assessed, the Appeals Technical Employee (ATE) will close the case and return it to the originating function as a premature referral.

Note: IRM 20.1.9.2 (20) and IRC 6751 requires Managers approve the International penalty case control, sign notice letters, and approve the International penalty by signing Form 8278 prior to closing the penalty case file from Examination. Automatically assessed penalties from Service Centers will not include Form 8278 as they are excepted from approval requirement per IRC §6751(b)(2).

IV. Relevant Case Law Regarding Section 6751(b):

A. *Kroner v. Comm'r of Internal Revenue*, 48 F.4th 1272 (11th Cir. 2022): The Court in *Kroner* held “We likewise see nothing in the text that requires a supervisor to approve penalties at any particular time before assessment.” and disagreed with the ruling in *Chai*. the 11th circuit disagreed with *Chai* and the reasons why they disagreed with *Chai* re timing of the assessment.

1. Regarding the preassessment deadline, the Court disagreed with *Chai* holding that “we do not think the statute needs pre-assessment deadline to reduce the use of improper penalties as “bargaining chip[s].” *Chai*, 851 F.3d at 219 (quoting S. Rep. No. 105–174, at 65 (1998)). The *Chai* court understood Section 6751(b)’s purpose to be about policing pre-assessment settlement negotiations. See *id.* at 219–20. But negotiations do not end after a penalty is assessed.”
2. The Court believed that “The statute thus incentivizes supervisory involvement at an early stage in the negotiation process and disincentivizes agents from proposing improper penalties solely for the sake of negotiations.”

- B. *Grajales v. Comm'r of Internal Revenue*, 47 F.4th 58 (2d Cir. 2022): The Court held that “the exaction on early distributions from a qualified retirement plan is a tax, not a penalty, addition to tax, or additional amount subject to written supervisory approval requirement,” because “the terms “penalty,” “additional amount,” and “addition to tax” do not appear in Section 72(t). Congress deliberately omitted them from Section 72(t); they are incorporated in other provisions of the Code.”
- C. *Laidlaw’s Harley Davidson Sales, Inc. v. C.I.R.*, 29 F.4th 1066 (9th Cir. 2022): The Ninth Circuit based its interpretation of section 6751(b) on the plain language of the statute. Held that IRS complied with procedural requirement of written supervisory approval before assessing penalty. Court ruled that 6751(b) was a procedural statute that did not require interpretation of legislative history.
- D. *Beland v. Comm'r of Internal Revenue*, 156 T.C. 80 (2021): The Court held, following the ruling in *Clay*, *Belair Woods*, and *Oropeza II* that “there was no reason to limit the means of communication of the initial determination to the mail; instead, this communication may occur in person during a formal IRS meeting held at the final stage of the examination process.”
- E. *Clay v. Comm'r of Internal Revenue*, 152 T.C. 223 (2019), aff’d, 990 F.3d 1296 (11th Cir. 2021): The Court found for Respondent on the issue of initial determination, because “when those proposed adjustments are communicated to the taxpayer formally as part of a communication that advises the taxpayer that penalties will be proposed and giving the taxpayer the right to appeal them with Appeals (via a 30-day letter), the issue of penalties is officially on the table... we conclude that the initial determination for purposes of section 6751(b) was made no later than... when respondent issued the RAR to petitioners proposing adjustments including penalties and gave them the right to protest those proposed adjustments.”
- F. *Belair Woods, LLC v. Comm'r of Internal Revenue*, 154 T.C. 1 (2020): The Court concluded “that the summary report transmitting the exam team's tentative penalty proposals did not require prior supervisory approval.”
- G. *Oropeza v. Commissioner*, 155 T.C. 132 (October 13, 2020): The Tax Court held that the Letter 5153 and RAR formally communicated the penalty to the taxpayer and the Service had no properly obtained supervisory approval before the issuance of those items. The Tax Court also held that Section 6662(i) (which increasing the penalty from 20% to 40% for underpayments attributable to nondisclosed noneconomic substance transactions) penalty increases are not separate penalties and supervisory approval was required on the originally determined penalty, in this case it was penalties under Section 6662(a) and (b)(6). *Choong Koh v.*

Commissioner, T.C. Memo. 2020-77: the Tax Court reaffirmed that Chief Counsel attorneys can make an initial determination of a penalty in their answer to the taxpayer=s petition. Chief Counsel attorneys are deemed representatives of the Commissioner and are, therefore, able to assess penalties in their answer.

- H. *Choong Koh v. Commissioner*, T.C. Memo. 2020-77: the Tax Court reaffirmed that Chief Counsel attorneys can make an initial determination of a penalty in their answer to the taxpayer=s petition. Chief Counsel attorneys are deemed representatives of the Commissioner and are, therefore, able to assess penalties in their answer.
- I. *Wells Fargo & Company v. United States*, 957 F.3d 840 (8th Cir. 2020): the Eighth Circuit determined that supervisorial approval under Section 6751(b) was not required where a negligence penalty, under Section 6662, was asserted as an offset to a refund action. Thus, the penalty was never assessed and would not be assessed because it was brought as an offset defense.
- J. *Graev v. Comm'r of Internal Revenue*, 149 T.C. 485 (2017): “Having considered the opinion of the Court of Appeals for the Second Circuit in *Chai*, and in the interest of repose and uniformity on an issue that touches many cases before us, we reverse those portions of *Graev II* which held that it was premature to consider section 6751(b) issues in this deficiency proceeding...In the light of our holding that compliance with section 6751(b) is properly at issue in this deficiency case, we also hold that such compliance is properly a part of respondent's burden of production under section 7491(c).”
- K. *Chai v. Comm'r of Internal Revenue*, 851 F.3d 190 (2d Cir. 2017): The Court in *Chai* held Written approval of initial penalty determination was required no later than date IRS issued notice of deficiency, or filed answer or amended answer, asserting such penalty.
 - 1. The Court in *Chai* agreed with the dissent in *Graev III* finding that “Th[e majority's] construction is implausible in the extreme—especially in an instance in which a penalty assertion becomes the subject of Tax Court litigation. Once Chief Counsel had argued and the Tax Court had held that the taxpayer is liable for an assessment, the supervisor's Johnny-come-lately approval of the “initial determination” would add nothing to the process. And where the Tax Court had held the taxpayer not liable for the penalty, the supervisor's consideration of the matter would then be moot.”

2. Also the court held we further hold that compliance with § 6751(b) is part of the Commissioner's burden of production and proof in a deficiency case in which a penalty is asserted.

V. Practice Points

A. Verifying Through a FOIA Request

1. To determine whether the Service satisfied its supervisory approval requirement, the tax practitioner can request documents through the Freedom of Information Act (FOIA). Title 5 Code Section 552 of the United States Code requires all United States agencies to provide information upon request.
2. Tax practitioners can send two distinct types of FOIA requests, one for IRS policies and procedures and the other for business or individual taxpayer records. Supervisory approval requests should be sent to the IRS office handling individual and business taxpayers, at:
Internal Revenue Service Central Processing Unit Stop 93A Post Office Box 621506, Atlanta, GA 30362, Fax: 877-891-6035.
3. Tax practitioners submitting a FOIA request should request evidence of supervisory compliance in both general and specific terms. Generally, tax practitioners should request all documents evincing compliance with Section 6751(b), including any documents showing supervisory approval.
4. As part of the Taxpayer First Act, taxpayers can now request a copy of their case file under Section 7803(e)(7). It is recommended that taxpayers and tax practitioners request a copy of the entire case file, or, at the least, request the portions of the case file that include Section 6751(b) compliance. This request, however, is only available to taxpayers who either have an adjusted gross income of less than \$400,000 for the taxable year in which the dispute arises (if a natural taxpayer), or whose gross receipts do not exceed \$5,000,000 for the taxable year in which the dispute arises (for any other taxpayer).
5. Tax practitioners should make both general and specific requests to ensure that the request is broad enough to cover all items needed but also specific enough that documents cannot fall through the cracks. Once the tax practitioner receives his FOIA response, he should review the entire FOIA response (including time entries of the revenue agent and supervisor) to see if and when supervisory approval was obtained.

6. The Service has the burdens of proof and production, under Section 7491(c), regarding penalties, including compliance with Section 6751(b). Thus, if the Service has not provided evidence reflecting compliance with Section 6751(b), the validity of the penalty should be challenged, and the challenge should be raised in the Tax Court petition. There is, however, a current debate regarding whether failure to raise the Section 6751(b) challenge in the petition forecloses the taxpayers' ability to challenge it. Failure to include a challenge in the Tax Court petition is, according to Rule 34 of the Tax Court Rules of Practice and Procedure, deemed a concession/waiver. See *Ohde v. Commissioner*, T.C. Memo. 2017-137, n. 6. Section 7491(c) compliance is a condition precedent to assessing a penalty and part of the IRS's burden and, therefore, whether Rule 34 (or any court rule) can limit or restrict a statutory condition precedent. For the time being, taxpayers should be aware of the IRS and Tax Court's position and should include the Section 6751(b) challenge in their petition. But this may not be a prohibitive restriction moving forward.

B. Verifying through Collection Due Process Hearings and Summarily Assessable Penalties:

1. Section 6751(b) challenges should be raised during a collection due process ("CDP") hearing. CDP hearings allow for both verification and substantive challenges. Substantive challenges allow you to challenge the merits of the underlying liability (i.e. the penalty). Substantive challenges are not always allowed and may only be brought when the taxpayer has not received a statutory notice of deficiency or has not had a prior opportunity to challenge the merits of the underlying liability.
2. Verification challenges, on the other hand, are always allowed and verify whether the IRS has satisfied all applicable rules and laws when making their determination (i.e. the penalty assessment). Since Section 6751(b) compliance is a condition precedent to assessing the penalty, it should be included as part of the verification challenge and is, therefore, always available in a CDP hearing.
3. Summarily assessed penalties are penalties assessed like taxes, which can typically be collected by notice and demand for payment. Summarily assessed penalties are mainly in Chapter 68 of the Code, which covers assessable penalties, additions to the tax, and additional amounts. To wit, Section 6665 (which applies to additional amounts and additions to the tax) provides: The additions to the tax, additional amounts, and penalties provided by this chapter shall be paid upon notice and demand and shall be

assessed, collected, and paid in the same manner as taxes.” Section 6671(a) (which applies to assessable penalties) similarly provides: “[t]he penalties and liabilities provided by this subchapter shall be paid upon notice and demand by the Secretary, and shall be assessed and collected in the same manner as taxes.”

Reasonable Cause² & Good Faith

<https://www.irs.gov/payments/penalty-relief-for-reasonable-cause>

Generally, relief from penalties falls into the following categories.

1. Correction of IRS error. See IRM 20.1.1.3.4 (08/05/2014)
2. Statutory and Regulatory exceptions (IRM 20.1.1.3.3.1 (10/19/2020))
3. Administrative waivers (IRM 20.1.1.3.3.2 (08/05/2014))
4. First Time Abate (FTA) (IRM 20.1.1.3.3.2.1 (10/19/2020))
5. Undue Hardship. (IRM) 20.1.1.3.3.3 (08/05/2014)
6. Reasonable cause

See e.g. IRM 20.1.1.3 (10/19/2020). This outline reviews the defense known as “reasonable cause.”

At the outset, reasonable cause relief is not available for all penalties; however, other exceptions may apply for those penalties where reasonable cause can be considered, any reason which establishes that the taxpayer exercised ordinary business care and prudence, but could not comply with a prescribed duty within the prescribed time, should always be explained in the penalty abatement request.

The chart below shows some penalties that can be abated based on reasonable cause.

Statute	Type of Penalty	Reasonable Cause Relief	Other Relief
IRC 6039E	Failure to Provide Information Concerning Resident Status	Yes	Yes
IRC 6651(a)(1)	Failure to File Tax Return	Yes	Yes
IRC 6651(a)(2)	Failure to Pay Tax When Due	Yes	Yes
IRC 6651(a)(3)	Failure to Pay Within 10 Days of Notice of Additional Tax Due (notices issued before 1/1/1997)	Yes	Yes
IRC 6651(a)(3)	Failure to Pay Within 21 Days of Notice of Additional Tax Due (10 business days if amount is \$100,000 or more) (notices issued after 12/31/1996)	Yes	Yes
IRC 6651(f)	Fraudulent Failure to File	No	No

² See *Reasonable cause and good faith exception to section 6662 penalties.*
<https://www.law.cornell.edu/cfr/text/26/1.6664-4>

Statute	Type of Penalty	Reasonable Cause Relief	Other Relief
IRC 6652(a)(1)	Failure to File Certain Information Returns	Yes	Yes
IRC 6652(c)(1)	Failure to File Annual Return by Exempt Organization	Yes	Yes
IRC 6652(c)(2)	Failure to File Returns Under IRC 6034 or IRC 6043(b))	Yes	Yes
IRC 6652(d)(2)	Notification of Change in Status of a Plan	Yes	Yes
IRC 6652(e)	Information Required in Connection With Certain Plans of Deferred Compensation—Form 5500, <i>Annual Return/Report of Employee Benefit Plan</i>	Yes	Yes
IRC 6652(h)	Failure to Give Notice to Recipients of Certain Pension, Etc., Distributions	Yes	Yes
IRC 6652(i)	Failure to Give Written Explanation to Recipients of Certain Qualifying Rollover Distributions	Yes	Yes
IRC 6652(j)	Failure to File Certification With Respect to Certain Residential Rental Projects	Yes	Yes
IRC 6654	Estimated Tax Penalty on Individuals	No	Yes
IRC 6655	Estimated Tax Penalty on Corporations	No	No
IRC 6656(a)	Failure to Deposit	Yes	Yes
IRC 6657	Bad Checks	Yes	Yes
IRC 6662	Accuracy-Related Penalty on Underpayments	Yes*	Yes
IRC 6662A	Accuracy-Related Penalty on Understatements With Respect to Reportable Transactions	Yes*	Yes
IRC 6663	Fraud	No	No
IRC 6676	Erroneous Claim for Refund or Credit	Yes	No
IRC 6692	Failure to File Actuarial Report	Yes	Yes
IRC 6698	Failure to File Partnership Return	Yes	Yes
IRC 6699	Failure to File S Corporation Return	Yes	Yes
IRC 6721	Failure to File Correct Information Reporting Returns	Yes	Yes

Statute	Type of Penalty	Reasonable Cause Relief	Other Relief
IRC 6722	Failure to Furnish Correct Payee Statements	Yes	Yes
IRC 6723	Failure to Comply With other Information Reporting Requirements	Yes	Yes

Sources of Law

The following Treas. Regs. contain examples of circumstances that may be helpful in determining if a taxpayer has established reasonable cause:

Rule	Description
Treas. Reg. 1.6664-4	Accuracy-Related Penalties (see IRM 20.1.5). See also https://www.law.cornell.edu/cfr/text/26/1.6664-4
Treas. Reg. 301.6651-1(c)	Failure to File a Tax Return and/or Failure to Pay tax Penalties (see IRM 20.1.2)
Treas. Reg. 301.6724-1	Information Returns Penalties (see IRM 20.1.7)
Treas. Reg. 1.6694-2(e)(1)-(6)	Tax Return Preparer Penalties (see IRM 20.1.6)
Treas. Reg. 301.6707-1(e)(3)	Material Advisor Penalties (see IRM 20.1.6.16)
Policy Statement 3-2,	Reasonable Cause for Late Filing of Return or Failure to Deposit or Pay Tax When Due. See IRM 1.2.1.4.2.
Policy Statement 3-3,	Timely Mailed Returns Bearing Foreign Postmarks to Be Accepted. See IRM 1.2.1.4.3.
Policy Statement 3-5,	Unsigned Income Tax Returns Will Not Be Accepted for Processing; Delinquency Penalty Generally Will Not Be Imposed on Timely Filed Unsigned Income Tax Returns. See IRM 1.2.1.4.5.

What is a reasonable cause?

Reasonable cause requires that the taxpayer exercised ordinary business care and prudence. Ordinary business care and prudence is defined as taking that degree of care that a reasonably prudent person would exercise, but nevertheless being unable to comply with the law.

https://www.irs.gov/pub/irs-utl/reasonable_cause_good_faith.pdf. The PDF is attached to this outline.

What factors inform whether a taxpayer had reasonable cause?

Each penalty case is evaluated based on its facts and circumstances. In re Wyly, 552 B.R. 338, 578 (Bank. R. Ct. N.D. Tex. May 10, 2016) (quoting Brinkley v. Commissioner, 808 F.3d 657, 669 (5th Cir. 2015)).

The tax professional should evaluate:

1. What happened and when did it happen?
2. During the time the taxpayer was noncompliant, what facts and circumstances prevented the taxpayer from filing a return, paying a tax, and/or otherwise complying with the law?
3. How did the facts and circumstances result in the taxpayer not complying?
4. How did the taxpayer handle the remainder of his or her affairs during this time?
5. Once the facts and circumstances changed, what attempt did the taxpayer make to comply?

The IRS will not find that “reasonable cause” existed if the penalty abatement request does not show that the taxpayer’s noncompliant behavior has ceased to exist. See *e.g.*, IRM 20.1.1.3.2 (11/21/2017) *Reasonable Cause*. https://www.irs.gov/irm/part20/irm_20-001-001r

How does a taxpayer establish he or she acted with ordinary business care and prudence?

A taxpayer establishes that he or she exercised ordinary business care and prudence (taking that care that a reasonably prudent person would exercise) but could not comply with the law. The tax professional must evaluate:

1. The Taxpayer’s Explanation:

The taxpayer’s penalty abatement should address the penalty imposed. To show reasonable cause, the dates and explanations should 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.

2. 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 for reasonable cause.

3. Length of Time

The penalty abatement should discuss the time between the event cited as a reason for the noncompliance and subsequent compliance. Explain:

- (1) when the act was required by law,
- (2) the time during which the taxpayer could not comply with the law due to circumstances beyond the taxpayer's control, and
- (3) when the taxpayer complied with the law.

See IRM 20.1.1.3.2, reasonable cause.

4. Circumstances Beyond the Taxpayer's Control

Explain why the taxpayer could not 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 could not timely meet the tax obligation.

5. International Penalties.

The IRS's position for taxpayers who conduct business or transactions offshore or in foreign countries have a responsibility to exercise ordinary business care and prudence in determining their filing obligations and other requirements. It is not reasonable or prudent for taxpayers to have no knowledge of, or to solely rely on others for, the tax treatment of international transactions.

IRM 20.1.9.1.1.(4) (10/24/2013); 20.1.9.2.(15) (11/30/2015).

What are the commonly asserted reasonable cause based defenses to penalties?

1. Fires, natural disasters or civil disturbances. See IRM 20.1.1.3.2.2.2 (10/19/2020) *Fire, Casualty, Natural Disaster, or Other Disturbance-reasonable cause.* The penalty abatement request should address:

- a) Timing
- b) Effect on the taxpayer's business
- c) Steps taken to comply
- d) If the taxpayer complied when it became possible

See also IRM 20.1.1.3.3.6 (11/25/2011)(Official Disaster Area)

2. Inability to get records. IRM 20.1.1.3.2.2.3 (12/11/2009) *Unable to Obtain Records.* The penalty abatement request should address:

- a) Why the records were needed to comply.
- b) Why the records were unavailable and what steps were taken to secure the records.
- c) When and how the taxpayer learned he or she did not have the necessary records.
- d) If other means were explored to secure needed information.

- e) Why the taxpayer did not estimate the information.
- f) If the taxpayer contacted the IRS for instructions on what to do about missing information.
- g) If the taxpayer promptly complied once the missing information was received.
- h) Supporting documentation such as copies of letters written and responses received in an effort to get the needed information.

3. Ignorance of the Law. IRM 20.1.1.3.2.2.6 (11/25/2011) Rarely, the IRS will consider reasonable cause if the taxpayer shows ignorance of the law in conjunction with other facts and circumstances. The abatement request should discuss:

- 1. The taxpayer's education.
- 2. If the taxpayer has previously been subject to the tax.
- 3. If the taxpayer has been penalized before.
- 4. If there were recent changes in the tax forms or law which a taxpayer could not reasonably be expected to know.
- 5. The level of complexity of a tax or compliance issue.
- 6. Whether a reasonable and good faith effort was made to comply with the law, or
- 7. Whether the taxpayer was unaware of a requirement and could not reasonably be expected to know of the requirement.

4. Reliance on a tax professional. See generally, <https://www.thetaxadviser.com/issues/2017/nov/reliance-preparer-erred-reasonable.html>. See also § 1.6664-4 reasonable cause and good-faith exception to section 6662 penalties. The abatement request should discuss

- a) Efforts the taxpayer made to report the correct tax.
- b) The complexity of the tax issues.
- c) The taxpayer's education, experience, or knowledge of the tax law.
- d) The steps taken by the taxpayer to understand his or her tax obligations or seek help from a tax advisor.
- e) If the taxpayer relied on a tax advisor, what information was provided to the taxpayer and whether the tax advisor was competent and/or sufficiently experienced.

[This list above is not exclusive]

Recent Cases:

A. *Schweizer v. Comm'r of Internal Revenue*, 124 T.C.M. (CCH) 232 (T.C. 2022): The “taxpayer failed to establish that enrolled agent at accounting firm advised him that he did not need to include with tax return qualified appraisal or completed tax form with information about art, and taxpayer failed to establish reliance on any such advice. [Reliance rejected]

B. *Remisovsky v. Comm'r of Internal Revenue*, 124 T.C.M. (CCH) 124 (T.C. 2022): The Court held

“Taxpayers failed to demonstrate that taxpayer's alcoholism and depression established reasonable cause for failure to timely file tax return and pay tax, as would have excused them from liability for addition to tax resulting from such failure; while taxpayer offered generalized testimony that he had struggled with depression and alcoholism, he did not testify that he had such conditions when return should have been prepared and filed or when delinquent return was submitted with no payment, even assuming taxpayer had conditions at relevant times, he offered no evidence concerning their severity, and he received substantial wages for practicing medicine during tax year at issue, and even if taxpayer were too ill to file, taxpayers presented no evidence that other taxpayer was unable to discharge that obligation.” [Illness requested]

C. *Kelly v. Comm'r of Internal Revenue*, 121 T.C.M. (CCH) 1561 (T.C. 2021): The Court determined that Petitioner provided the necessary information to his tax preparer identifying a foreign entity and advised the preparer that he was unsure of the reporting requirements. Therefore Mr. Kelly reasonably relied on his tax preparer to prepare his returns properly. [Reliance accepted]