# Complex IRS Penalty Abatement Procedures for Failure-to-File, Failure-to-Pay, and Accuracy-Related Penalties

THURSDAY, MAY 14, 2020, 1:00-2:50 pm Eastern

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# Complex IRS Penalty Abatement Procedures for Failure-to-File, Failure-to-Pay, and Accuracy-Related Penalties

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Dennis N. Brager, Esq., Certified Tax Specialist
Brager Tax Law Group
dbrager@bragertaxlaw.com

Robert V. Hanson, Esq., International Tax Attorney
Parent & Parent
rvh@irsmedic.com

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# IRS Penalties, Abatements and Related Topics

Robert V. Hanson, Esq.

# Robert Hanson, Esq.

Parent & Parent LLP
Tel: (203)269-6699

IRS MEDIC
parent & parent llp

The claimed purpose of tax penalties is supposed to be to discourage taxpayers from evading taxes and ensuring compliance, not simply to make the government money. Yet this is claimed purpose is wholly undermined by our reality.

I see no harm in adopting the belief that the IRS wants to desperately penalize your clients - the more the better.

"In 1955, there were approximately 14 penalty provisions in the Internal Revenue Code. There are now more than ten times that number. With the increasing number of penalty provisions, the IRS recognized the need to develop a fair, consistent, and comprehensive approach to penalty administration." I.R.M. 20.1.1.1.

The only thing that is somewhat consistent is First Time Penalty Abatement (FTA). Everything else you might appear unfair, inconsistent, or ad hoc.

# What we will cover

- Failure-to-File and Failure-to-Pay Penalties (IRC §6651)
- First-time Penalty Abatement
- Underpayment of estimated tax by individuals (IRC §6654)
- Underpayment of estimated tax by corporations (IRC §6655)
- Accuracy-related Penalties (IRC §6662)
- Benefits of the different types of Installment Agreements
- Understanding the reasonable cause standard for domestic penalties

# Failure-to-File and Failure-to-Pay Penalties (IRC §6651)

- Failure-to-File:
  - Failure to file a return by the due date (including applicable extensions) will result in the assessment of a penalty of 5% of the amount of tax required to be shown on the return for each month or part thereof that the return remains unfiled, up to a maximum of 25% of the tax shown as owing.
    - The amount of tax to which the penalty applies is reduced by any part of the tax paid on or before the date prescribed for payment of the tax shown and by the amount of any credit claimed against the tax shown on the return.
    - If no additional tax is due with the return or a taxpayer is owed a refund, there is no penalty for failure to file by the filing deadline.
  - In the case of a failure to file that is deemed to be fraudulent, failure-to-file penalties accrue at an increased rate of 15% and the maximum failure-to-file penalty is increased from 25% to 75%.

# Failure-to-File and Failure-to-Pay Penalties (IRC §6651)

-Failure-to-Pay:

- Failure to pay the amount of tax shown as owing on a return will result in a penalty in the amount of 0.5% of the amount of tax remaining unpaid for each month or fraction thereof that the tax remains unpaid at the beginning of the month to which the penalty applies.
- If the tax remains unpaid 10 days subsequent to a taxpayer receiving a Final Notice of Intent to Levy issued under IRC §6331, the failure-to-pay penalty begins accruing at a rate of 1% per month.

# Failure-to-File and Failure-to-Pay Penalties (IRC §6651)

- Benefits of an Installment Agreement:
  - In the case of a timely-filed return, the accrual of failure-to-pay penalties are reduced to .25% of the tax owing once a taxpayer has entered into an installment agreement with respect to the tax balance to which the penalty applies.

# Failure-to-File and Failure-to-Pay Penalties (IRC §6651)

- Safe harbor Provisions
  - If you timely requested an extension of time to file your income tax return and paid at least 90% of the taxes owing on the return by the due date to pay, you will not be subjected to FTP penalties if the tax is paid in full by the extended deadline. Interest on the underpayment will still accrue between the due date for payment and the date that the taxes are paid in full.

# Failure-to-File and Failure-to-Pay Penalties (IRC §6651)

-Both Failure-to-File and Failure-to-Pay:

- If both FTF and FTP penalties apply in a given month, the maximum amount charged for those two penalties (in the absence of a fraudulent FTF determination) is a combined 5% (4.5% for failure-to-file and .5% failure-to-pay).
- If both failure-to-file and failure-to-pay penalties are asserted, the maximum total combined penalty is 47.5% (22.5% late filing and 25% late payment) of the tax owing.

# Failure-to-File and Failure-to-Pay Penalties (IRC §6651)

- Requesting non-assertion of penalties on a late-filed return:
  - A written request for non-assertion of penalties for failure-to-pay and/or failure to file can be attached to and submitted along with a delinquent tax return.
    - Such requests are typically made under reasonable cause grounds, meaning the taxpayer must show that a failure to file a tax return or pay tax owing by the specified due date was due to reasonable cause and not willful neglect.

# Failure-to-File and Failure-to-Pay Penalties (IRC §6651)

- Requesting abatement of failure-to-file and failure-to-pay penalties post-assessment:
  - A request for abatement generally must be made in writing, and can take the form of a written request for penalty abatement or by filing a Form 843 - Claim for Refund and Request for Abatement.
    - Included with a statement of the facts and circumstances giving rise to the grounds for abatement, the taxpayer should provide as much supporting documentation as possible to substantiate their claim.
    - Generally a separate Form 843 must be filed for each period for which penalty abatement is being requested.
    - A duly-authorized representative may make a written request for penalty abatement on behalf of a taxpayer, but must include a copy of the Form 2848 authorizing them to do so.
    - Written requests for reasonable cause abatement generally require that such request include a statement from the taxpayer or their representative that the statement of facts and circumstances outlined in the request is made under penalties of perjury.

# Failure-to-File and Failure-to-Pay Penalties (IRC §6651)

- Appealing a denied request for penalty abatement:
  - The IRS will issue a notice to the taxpayer stating whether or not their claim for penalty abatement was approved. If denied, the IRS will list the reason for the denial and provide 60 days for the taxpayer to request an appeal of the determination.
    - A request for an appeal of an IRS determination to deny penalty relief must be made in writing.
    - The IRS will often deny requests for penalty abatement initially, but Appeals is generally more receptive to considering a taxpayer's arguments. If nothing else, filing an appeal will generally allow you to speak directly with someone at the IRS considering your request in order to advocate for the claim's acceptance.

# Failure-to-File and Failure-to-Pay Penalties (IRC §6651)

Reasonable Cause Abatement:

- To establish reasonable cause, a taxpayer must show that that they exercised ordinary business care and prudence but was nevertheless unable to file / pay within the prescribed time.
- The determination to grant reasonable cause relief is largely a subjective one on behalf of the IRS. The IRS considers the following information in making a determination whether reasonable cause exists:
  - Taxpayer's reason: specific dates and causes of the failure should be outlined by the taxpayer as a basis for abatement.
  - Compliance history: The IRS will often check the taxpayer's overall compliance history, especially for the three years preceding the year for which abatement has been requested. If there is a history of non-compliance, that may be used as justification by the IRS to deny relief.
  - Length of time: The IRS will consider the length of time that has elapsed between the event cited as giving rise to the taxpayer's failure to comply and the date on which the taxpayer was able to comply.
    - Generally speaking, if the taxpayer does not attempt to rectify the non-compliance promptly after the event giving rise to the non-compliance has subsided, that can be used as grounds to deny relief.
  - Circumstances beyond the taxpayer's control: The IRS will consider whether the circumstances giving rise to the non-compliance could have been anticipated by the taxpayer and actively avoided. If so, the taxpayer may be found to have failed to exercise ordinary business care and prudence.

# Failure-to-File and Failure-to-Pay Penalties (IRC §6651)

- Events commonly giving rise to Reasonable Cause:
  - Death, serious illness, or unavoidable absence.
    - Generally requires the death or serious illness of the taxpayer or someone in their immediate family.
    - Especially with corporations, if someone else had the authority to file the return on behalf of the person prevented from doing so, that may be justification for denying relief.
    - The IRS will closely scrutinize how long it took the taxpayer to comply once the death, illness, or absence giving rise to the non-compliance.
  - Fire, Casualty, Natural Disaster or other Disturbance:
    - If the taxpayer has been deemed a person affected by a widespread disaster officially recognized by the IRS, relief under these grounds should be straightforward and processed as an administrative waiver.
    - If not resulting from an officially recognized disaster, the IRS will consider the facts and circumstances surrounding the disaster's impact on the individual taxpayer's ability to comply.
  - Inability to obtain records:
    - Typically requires a showing of the facts and circumstances giving rise to the inability to obtain records and the steps that the taxpayer took to attempt to obtain the information prior to the due date of the return.
  - Reliance on erroneous advice:
    - While reliance on erroneous written advice from a tax professional or IRS employee may give rise to an abatement of certain penalties, it is generally not a basis upon which a claim for reasonable cause abatement of failure-to-file or failure-to-pay may rest, as the duty to file and pay taxes cannot be delegated by a taxpayer.

# Reasonable Cause

- IRS reasonable cause determinations include a high standards and penalty of "wiggle room" with the determination.
- What this means is that if you have two identical cases, you can expect two different results. Just because you lost on a very similar reasonable cause abatement, does not mean you will lose with another client.

# First time penalty abatement

- Not nearly as subjective, almost neatly objective. But we've seen rules not followed for our benefit.
- So you might want to try squeezing something in.

# First time penalty abatement

First-time Penalty Abatement:

- If a taxpayer cannot establish reasonable cause for the abatement of failure-to-file or failure to pay penalties, they may be able to get relief via an administrative waiver under the IRS's First Time Abatement (FTA) policy.
  - FTA has been an administrative waiver available for penalty relief since 2001.
    - The eligibility criteria were substantially altered in November of 2017, so much of the information online related to FTA is now outdated.
  - FTA applies to the abatement of Failure-to-File, Failure-to-Pay, and Failure-to-Deposit (business) taxes.
  - Only applies to tax periods ending later than Dec. 31, 2000.

# First time penalty abatement

-Eligibility criteria:

- A taxpayer must have filed, or have filed a valid extension for, all currently required returns (generally a 6 year look-back period) and must have paid or arranged to pay their tax liabilities.
- With the exception of an estimated tax penalty, the taxpayer must not have incurred any unreversed penalty of any amount on any required return of the same type during the three years immediately preceding the year for which abatement is being abated.

# First time penalty abatement

- FTA may have to be done twice

-In the case of a request for FTA while the taxpayer is still in an agreement to repay their taxes, the IRS will abate failure-to-pay penalties when the taxpayer requests FTA relief, but failure-to-pay penalties will then begin to accrue again on that balance until the balance is paid in full. While FTA is only available for one tax period, a taxpayer can request FTA be applied again to the same tax period once the balance has been paid in full to ensure that any failure-to-pay penalties that have accrued since the initial abatement are also backed out.

# First time penalty abatement

- Filing Status and FTA

-If the penalties eligible for abatement are the result of a MFJ return, both SSNs associated with the joint filing must meet eligibility requirements for the three preceding years, even if returns were not filed jointly in the preceding years.

# First time penalty abatement

- Be Specific

-While the IRM states that penalty relief is available for the "first time" a taxpayer is subject to one of the penalties eligible for abatement, often time taxpayers will have multiple tax years with 3 years of clean compliance preceding them. The IRS has abated penalties for periods that were not the taxpayer's earliest eligible year, so it is best practice to specifically ask for the year with the most penalty eligible for abatement rather than the earliest period eligible for abatement.

# Estimated Tax Penalty: Underpayment of estimated tax by individuals (IRC §6654):

- Estimated tax payments are required if a taxpayer expects to owe at least $1,000 in tax after subtracting withholding and refundable credits.
- The amount of the estimated tax penalty (ETP) is calculated using Form 2210.
- There are two methods under which and ETP can be calculated:
  - Short Method
  - Regular Method

# Estimated Tax Penalty: Underpayment of estimated tax by individuals (IRC §6654):

- Short Method:
  - Can only be used if:
    - the taxpayer in question made no estimated tax payments (or the only payments made were withheld federal income tax), or
    - The same amount of estimated tax was paid on, or prior to, each of the four payment due dates.
      - Note that if payment was made prior to the installment due dates, the Short Method may be used, but may result in a larger penalty than would be calculated under the Regular Method.
    - ETP is calculated by:
      - STEP 1: Subtracting the amounts withheld from income and any estimated tax payments made during the year from the taxpayer's required annual payment figured on Part 1 of Form 2210. This is the taxpayer's total underpayment for the year.
      - STEP 2: If net from STEP 1 above is greater than zero, multiply that number by 0.02660. If the amount calculated in STEP 1 above was not paid in prior to April 15th, the penalty amount is the total underpayment multiplied by .02660.
      - STEP 3: If the total underpayment for the year was paid in before April 15th, the ETP is calculated by multiplying the total underpayment for the year calculated in STEP 1, multiplying it by the number of days prior to April 15th that the payment was made, multiplying that number by .00011, and subtracting the resulting number from the amount calculated in STEP 2.

# Estimated Tax Penalty: Underpayment of estimated tax by individuals (IRC §6654):

- Regular Method:
  - Must be used if:
    - Any estimated tax payments were made late,
    - A taxpayer's income varied during the year and the penalty would be reduced or eliminated when figured using the annualized income installment method,
    - The penalty is lower when figured by treating the federal income tax withheld from income as paid on the dates it was actually withheld, instead of in equal amounts on the payment due dates, or
    - The return being filed is a non-resident return for a taxpayer that didn't receive wages as an employee subject to U.S. income tax withholding.
  - The IRS estimates that the calculations under the Regular Method would take the average taxpayer over 4 hours to complete, so going through them step by step is probably impractical, however calculating the underpayment penalty under the regular method generally requires that an underpayment penalty be calculated separately for each of the four required installments based on the amounts paid and when.
  - The amount of each required payment is generally the taxpayer's required annual payment divided by four, but taxpayers do have the option to elect to use the Annualized Income Installment Method by completing Schedule AI on Form 2210.
    - The form allows a taxpayer to adjust the amount required in each of the four installments to reflect their actual income during the corresponding period. This may allow a taxpayer to reduce their estimated tax penalty.
      - Note that an election to use the annualized income method cannot be made selectively; if elected, it must be used to calculate the required installment for each quarter.

# Estimated Tax Penalty: Underpayment of estimated tax by individuals (IRC §6654):

- Safe harbor for individuals:
  - Most taxpayers will be exempt from an underpayment penalty if the total of their withholding and timely estimated tax payments equal the lesser of 90% of their current year tax liability or 100% of their prior year taxes.
  - In the case of high income taxpayers (AGI over $150,000 in prior year, or $75,000 if MFS), they will be exempt from an underpayment penalty only if the total of their withholding and timely estimated tax payments equal the lesser of 90% of their current year tax liability or 110% of their prior year tax.

# Estimated Tax Penalty: Underpayment of estimated tax by corporations (IRC §6655):

- Corporations (including S corporations), tax exempt organizations subject to the unrelated business income tax, and private foundations may all be subjected to a penalty for failure to pay estimated taxes.
- Corporate ETPs are figured using Form 2220, however the IRS generally instructs corporations not to file Form 2220 with their income tax returns, as the IRS will figure the amount of any penalty and notify the corporation.
- Corporations would generally only need to prepare and file Form 2220 if the corporation's total tax (after subtracting certain credits specified on Form 2220) is $500 or more for the year and:
  - The adjusted seasonal installment method is used,
  - The annualized income installment method is used, or
  - The corporation is a large corporation figuring its first required installment based on the prior year's tax.
    - A large corporation is a corporation (other than an S-Corp) that had taxable income of $1m or more for any of the 3 preceding years.

# Estimated Tax Penalty: Underpayment of estimated tax by corporations (IRC §6655):

Safe harbor for corporations:

- Corporations are generally exempt from ETP if it pays at least the smaller of:
  - 100% of the tax shown on its current year return, or
  - 100% of the tax shown on its prior year return, provided the return showed some tax owing and it was for a full 12 months.

# Estimated Tax Penalty: Underpayment of estimated tax by corporations (IRC §6655):

Safe harbor for corporations:

- Corporations are generally exempt from ETP if it pays at least the smaller of:
  - 100% of the tax shown on its current year return, or
  - 100% of the tax shown on its prior year return, provided the return showed some tax owing and it was for a full 12 months.

# Accuracy-related Penalties (IRC §6662)

- IRC §6662 authorizes the IRS to assess a penalty equal to 20% of any understatement of tax due to any of the following:
  - Negligence or disregard of rules or regulations
    - Negligence: "any failure to make a reasonable attempt attempt to comply with" the internal revenue laws
    - Disregard: any "reckless, careless, or intentional disregard."
  - Substantial understatement of income tax
    - Individuals: Amount of the understatement of tax exceeds the greater of 10% of the tax required to be reported or $5,000.
    - C-Corporations: Amount of the understatement of tax exceeds the lesser of 10% of the tax required to be shown on the return (or $10,000 if greater) or $10m.
  - Substantial valuation misstatement
  - Substantial overstatement of pension liabilities
  - Substantial estate or gift tax valuation understatement
  - Transactions lacking economic substance
  - Undisclosed foreign financial assets THIS IS JUST THE START!
  - Any inconsistent estate basis

# Accuracy-related Penalties (IRC §6662)

- The applicable accuracy-related penalty maybe increased to 40% when certain inaccuracies are deemed to be "gross" rather than "substantial."
- The accuracy-related penalty does not apply if the taxpayer adequately discloses the position on the return and there is a reasonable basis for the position taken or the taxpayer's position otherwise represents a good faith challenge to the regulation.

# Accuracy-related Penalties (IRC §6662)

-The applicable accuracy-related penalty maybe increased to 40% when certain inaccuracies are deemed to be "gross" rather than "substantial."

-The accuracy-related penalty does not apply if the taxpayer adequately discloses the position on the return and there is a reasonable basis for the position taken or the taxpayer's position otherwise represents a good faith challenge to the regulation.

# Accuracy-related Penalties (IRC §6662)

Substantial Authority:

-Regardless of prior disclosure, any position taken on a taxpayer's return which was based on "substantial authority" will be treated as if it were shown properly on the return for purposes of calculating the amount of tax shown on the return (and thus would not be included in any calculation of an understatement for that year).

# Accuracy-related Penalties (IRC §6662)

- Substantial authority generally includes the IRC, accompanying regulations, tax treaties and explanations, court decisions, legislative histories, private letter rulings, etc. (See Regs. Sec. 1.662(d)(3)(iii) for enumerated list of authorities).
  - Different authorities are afforded varying levels of weight depending on their source and relevance to the particular position.
- "Substantial authority standard" - an objective standard involving an analysis of the law relied upon and the application of the law to relevant facts.
  - Less stringent than the "more likely than not standard" (i.e. the standard that is met when there is a greater than 50% likelihood of the position being upheld).
  - More stringent than the "reasonable basis" standard applicable to positions that were adequately disclosed with the tax return.
- While disclosing a potentially contentious tax position potentially giving rise to an understatement may increase a client's risk of audit, it might also mean the difference between assessment and non-assessment of accuracy-related penalties, as different standards would apply in determining the appropriateness of penalty assessment.

# Accuracy-related Penalties (IRC §6662)

Reasonable Cause:

- Taxpayers are generally not liable for accuracy-related penalties for any portion of an underpayment for which "there was reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion."
- An analysis of reasonable cause abatement related to accuracy-related penalties is subject to much of the same analysis as that cited above for failure-to-file and failure-to-pay penalties, however unlike those penalties, reliance on the erroneous advice of a tax professional generally will give rise to reasonable cause in the context of accuracy-related penalties, provided:
  - the tax professional was a competent tax professional with sufficient expertise to justify reliance,
  - the taxpayer provided all necessary information to the professional,
  - the taxpayer reasonably relied on the advice in good faith (taking into account the taxpayer's education, sophistication and business experience),
  - the tax professional was not "the taxpayer" (i.e. an employee of a corporate taxpayer), and
  - the tax professional actually provided the advice to the taxpayer.
- As with other requests for reasonable cause, it is important to put together as much supporting documentation as possible to support the position that the taxpayer acted in good faith and with ordinary business care and prudence.

# Installment Agreements and penalty abatements

Establishing an Installment Agreement:

-<u>Guaranteed Installment Agreements:</u>

- Applies to individual taxpayers only.
- Balance of tax owing (without regard to interest or penalties) does not exceed $10,000.
- Taxpayer has not failed to file any return, pay any tax required to be shown on any such return, or entered into an installment agreement in the prior 5 taxable years.
- Agreement provides for a full repayment of the liability within 36 months.
- Can be established online or by calling the IRS.

# Installment Agreements and penalty abatements

Streamlined Installment Agreements:

- Balances of assessed tax, penalties, and interest of $50,000 or less.
  - Penalties and interest that have accrued, but have not been formally assessed do not count towards the $50,000 threshold.
  - No collection information statement (433-F, 433-A, or 433-B) required.
  - Does not require a lien determination prior to establishment for balances up to $25,000. A lien determination is not required for balances between $25,001 and $50,000 provided the taxpayer agrees to a direct debit agreement.
  - Requires repayment within 72 months or the number of months necessary to satisfy the liability in full prior to the Collection Statute Expiration Date (CSED), whichever is less.
  - Must have filed and returns due in last 6 years and be current with estimated tax and withholding obligations.
  - Operating business taxpayers are only eligible for streamlined installment agreements if their liabilities consist solely of income tax liabilities and the balance of assessed tax, penalties, and interest is $25,000 or less.
  - Out of business taxpayers will qualify for streamlined installment agreements for any tax type as long the balance of assessed tax, penalties, and interest is $25,000 or less.
  - Unlike other business taxpayers, out of business sole proprietors may qualify for streamlined installment agreements on balances between $25,001 and 50,000.
  - Can be established online, by calling the IRS, or requesting an installment agreement in writing.

# Installment Agreements and penalty abatements

Balances of assessed tax, penalties, and interest between $50,001 and $100,000:

- Beginning in 2016, the IRS began testing an expansion of the streamlined installment agreement criteria for taxpayers owing up to $100,000.
- Testing period ended in September 2018, and program was permanently added to IRM §5.19.1.6.4.11 on September 26, 2018.
- Minimum required payment is calculated by dividing assessed balance of tax, penalties, and interest by 84, or the amount required to pay the balance plus accruals prior to the expiration of any CSED.
- No Collection Information Statement required if set up as direct debit or payroll deduction.
- Lien filing determination is required.
- Does not apply to business taxpayers aside from sole proprietors and is not available to taxpayers that have been assigned to the field for collection (i.e. are working with a Revenue Officer).
- Can be established in writing or by calling the IRS. Cannot be established online.

# Installment Agreements and penalty abatements

In-Business Trust Fund Express Installment Agreements:

- Special streamlined installment agreement criteria that applies to operating businesses with payroll tax liabilities.
  - Must owe $25,000 or less at the time the agreement is established.
  - Debt must be full paid within 24 months or prior to CSED, whichever is earlier.
  - Must be a direct debit agreement if balance exceeds $10,000.
  - Must be compliant with all filing and payment / deposit requirements.
- Generally does not require the submission of a Collection Information Statement.
- Major benefit of IBTFE IA is that a determination of Trust Fund Recovery Penalty responsibility is not required so long as the business taxpayer establishes and complies with the terms of the agreement.

# Installment Agreements and penalty abatements

Non-streamlined Installment Agreements:

- If a taxpayer does not qualify for or otherwise cannot meet the terms of one of a guaranteed or streamlined installment agreement, a Collection Information Statement must be completed and submitted to the IRS in order to determine taxpayer's ability to make monthly payments towards the liabilities.

# Facts of the case

- IRS gets documents from a deferred-prosecution case with a Swiss bank
- Client's name and signature shows up on a document the bank has.
- IRS examines client.
- Client assumes she'll be able to show she's done nothing wrong, and uses her tax preparer as his representative.
- Exam concludes with 17 Form 5471 penalties for a total of $170,000.
- Client's tax representative calls us in a panic. What can be done?

# Facts of the case

- We review file. Client or representative never given copy of the bank record the IRS claims to have.
- Client admitted she did recall signing something years ago. Perhaps as a beneficiary. But she says the name of the business is not hers. It is her brothers who left the US a long time ago and she is estranged from him.
- IRS appears to look for FBAR penalties but can't as the associated account was closed in 2008 when the Swiss secrecy was collapsing.
- In the lead sheet, the examiner even says because the ASED on FBAR penalties is gone, the IRS is looking to assess Form 5471 penalties.
- But we actually don't know if our clients was a shareholder in her brother's company.
- Examiner loads up lead sheet with irrelevant information in order to paint the taxpayer as something he's not, like:

1. She received wires from abroad totally hundreds of thousands of dollars! Because she had a international customers completely unrelated to brother. This income was all properly reported.
2. Deposited analysis shows hundreds of thousands in unreported income. The deposits were from a divorce proceeds.

# How aggressive is the IRS?

- The penalty assessment procedure for the 2017 Form 5471 began PRIOR to the due date of any Form 5471.
- Nothing but tautology on why she was required to file a Form 5471 in the first place.
- We don't know if she was a shareholder, to what amount. IRS examiner never even bothers to mention it.

# Be prepared. It's dangerous time to have foreign assets and income.

- It's also dangerous NOT to have foreign assets and income.
- The IRS's examination new focus is on increased assessments, not ensuring compliance.
- Foreign penalties are a Vegas-sized buffet of huge penalties opportunities, with wide open ASED, and unfortunately, tax professionals not properly guarded against an unreasonable IRS

# Navigating Complex IRS Penalty Abatements

Dennis N. Brager, Esq.,

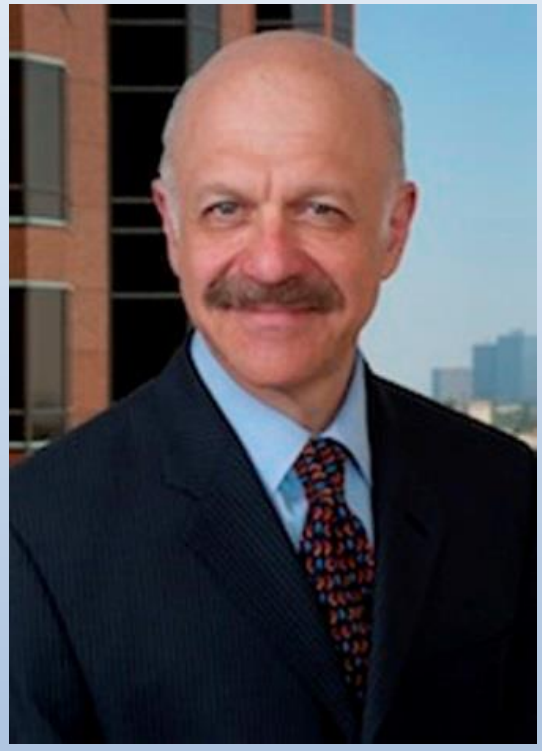
Brager Tax Law Group

Strafford Webinar

May 14, 2020

# Dennis Brager

- Ex-IRS Trial Lawyer
- State Bar Certified Tax Specialist
- 40+ Years Tax Dispute Experience with IRS, EDD, CDTFA, FTB Problems
- Nationally Recognized Tax Litigation Attorney



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# Dennis Brager

Dennis Brager is a California State Bar Certified Tax Specialist and a former Senior Trial Attorney for the Internal Revenue Service's Office of Chief Counsel. In addition to representing the IRS in court, he advised the Service on complex civil and criminal tax issues. He now has his own four attorney firm in Westwood, and has been named as a Super Lawyer in the field of Tax Litigation by Los Angeles Magazine. He has been quoted as a tax expert, by Business Week, the Daily Journal, the National Law Journal, The Daily Beast, USA Today, Palm Beach Daily News, Money Laundering, the Los Angeles Daily Journal and Tax Analyst.

Having worked for the IRS for six years, he gained valuable insight into the inner workings of that organization. This not only helps in developing the right strategies, but facilitates working with the system quickly and efficiently. Mr. Brager has limited his practice to representing clients having disputes with the IRS, the Franchise Tax Board, the State Board of Equalization and the Employment Development Department--both at trial and administrative levels.

He has appeared on ABC Television's Good Morning America show, Fox Business News, and TV One Access. He has also spoken before the California Continuing Education of the Bar, the California Society of CPAs, the UCLA Tax Controversy Institute, the California State Bar Tax Section, the Consumer Rights Litigation Conference, the California Trial Lawyers Association, the American Bar Association, the Warner Center Estate and Tax Planning Council, and the National Association of Enrolled Agents. Dennis Brager has been an instructor at Golden Gate University's Masters in Taxation Program and a guest speaker at the University of Southern California. Mr. Brager has testified as an expert witness on Federal tax matters.

His articles have appeared in the California Lawyer, Daily Journal, Taxation for Lawyers, Los Angeles Lawyer, The Consumer Advocate, Family Law News, California Tax Lawyer, Journal of Tax Practice and Procedure, and Journal of Taxation of Investments. They include "Offshore Voluntary Disclosure – The Next Generation," "Partial Offshore Tax Amnesty – Voluntary Disclosure 2.0," Anatomy of an OPR Case (Definitely Not R.I.P.)," "FBAR and Voluntary Disclosure," "The Tax Gap and Voluntary Disclosure," "Circular 230: An Overview," "Recent Developments in Tax Procedure," "Damages, Rescission and Debt Cancellation as Client Income," "Ponzi Scheme Victims May Be Able to Mitigate Losses with Tax Deduction," "Prevailing Party-Recovering Attorneys Fees From the IRS," "The Taxpayer Bill of Rights--A Small Step Toward Reining in the IRS," "Challenging the IRS Requires a Cohesive Strategy," "The Innocent Spouse Defense," "IRS Guidelines for Installment-Payment Agreements," "Expert Advice: New Rules on 1099 Forms," "Tax Brakes: The Taxpayer Bill of Rights 2," and "Expert Advice: Avoiding Payroll Taxes."

Mr. Brager received his undergraduate degree from Pace University (B.B.A., magna cum laude, 1975, Accounting/Finance), and his law degree from New York University (J.D., 1978). He is a former chair of both the Tax Compliance, Procedure and Litigation Committee of the Los Angeles County Bar Association, and the California State Bar, Tax Procedure and Litigation Committee. He is admitted to practice before the U.S. Supreme Court, the Ninth Circuit Court of Appeals, U.S. Claims Court, U.S. Tax Court, U.S. District Court and the U.S. Bankruptcy Court.

# IRC 6751(b) Written Approval

- 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.

- § 6751(b)(1) requires written approval of the initial penalty determination no later than the date the IRS issues the notice of deficiency (or files an answer or amended answer) asserting such penalty.
  *Chai v. Commissioner,* 851 F.3d 190, 221 (2d Cir. 2017)

# IRC 6751(b) History

- Section 6751 enacted (July 22, 1998)
- Section 6751 effective (notices issued after December 31, 2000)
- *Chai v. Commissioner*, T.C. Memo. 2015-42 (March 11, 2015)
- *Graev v. Commissioner*, 147 T. C. 460 (November 30, 2016) (aka Graev II)
- *Chai v. Commissioner*, 851 F.3d 190 (2nd Cir. March 20, 2017)
- *Graev v. Commissioner*, 149 T.C. 485 (December 20, 2017)(aka Graev III)
- Chief Counsel Notice CC-2018-006 (IRS Chief counsel attorneys instructed to concede cases where they can't show supervisory approval).

# IRC 6751(b) When? Who?

- Section 7491(c). The Commissioner bears the burden of production with respect to the liability of an *individual* for any penalty.
- The supervisor must approve the penalty no later than the earlier of a notice of deficiency or other formal communication sent to the taxpayer that advises penalties were determined and provides an opportunity to appeal. *Clay v. Commissioner*, 152 TC. 223 (2019) (revenue agent report sent with 30-day letter was initial determination; supervisor approval occurred after).
- *Endeavor Partners Fund, LLC v. Commissioner*, T.C. Memo 2018-96 (cannot cure failure to obtain supervisor approval by reasserting penalty in amended pleading approved by supervisor), aff'd on other grounds, 943 F.3d 464 (D.C. Cir. 2019)
- Can IRS counsel make an initial determination of a penalty? See Graev III, 149 T.C. at 529-532 (6 judges dissenting).
- Consider filing a FOIA request.
  - Why not just ask?

# CDP Hearings

- The Notice of Intent to Levy and Right to Request a Hearing is generally sent by certified or registered mail, return receipt requested, to a taxpayer's "last known address.“
- Taxpayer has 30 days to respond in writing by requesting a hearing.
  - During the Covid-19 Pandemic the taxpayer will have until July 16, 2020 to respond.
- Failure to respond in writing within the 30 days could result in a malpractice claim.
- Equivalent Hearing
- The hearing is before the IRS Independent Office of Appeals
- Issuing the Notice of Determination
- Appealing to the U.S. Tax Court
  - 30 days

# Not Just a Collection Remedy

- If the taxpayer has not receive a Notice of Deficiency, or "otherwise had an opportunity to dispute the liability she may challenge the existence or amount of the underlying tax liability in a CDP hearing.
- This includes any penalty. *Callahan v. Commissioner*, 130 T.C. 44,49-50 (2008).
- Generally all assessable penalties may be heard in a CDP hearing
- Assessable Penalties include:
  - Late filing
  - Late payment
  - Foreign Information form reporting penalties
  - TFRP.
- FBAR penalties can not be heard in a CDP hearing

# Prior Opportunity

- The Tax Court has long held that a prior opportunity is not merely a judicial opportunity.
  - A conference with the Office of Appeals is a prior opportunity. *Lewis v. Commissioner*, 128 T.C. 48, 61 (2007).
  - Prior opportunities include:
    - prior CDP hearing for the same tax and period. See
    - prior CDP Final Notice for the same tax and period
    - proof of claim filed by IRS in a bankruptcy proceeding suit to reduce to judgement or enforce a tax lien regarding the tax liability. IRM 8.22.8.3(8).
- A trap for the unwary.
  - Audit reconsideration with an Appeals Conference is a prior opportunity. *Lander v. Commissioner*, 154 TC No. 7 (2020).
  - Failing to request a CDP hearing for the same period in response to an IRS Notice of Tax Lien. *Smith v. Commissioner*, 2016 Tax Ct. Memo LEXIS 184 (2016).

# Not a Prior Opportunity

- 30-day letter in a deficiency case
- audit reconsideration if the taxpayer is not offered an Appeals conference
- a concurrent Appeals conference
- accrued interest & penalties not at issue in NOD or prior hearing
- the opportunity to file an amended return
- receipt of a math or clerical error notice
- the opportunity to pay and file a refund claim. IRM 8.22.8.3.9

# CDP Issues in Tax Court

- Notice of Determination. 30 days to file a Petition. Section 6330(d)(1).
  - Tax Court has sole jurisdiction.
- The underlying tax liability cannot be challenged in the Tax Court where it was not raised when the case was at Appeals. *Giamelli v. Commissioner*, 129 T.C. 107 (2007).
- Standard of Review is de novo. *Jones v. Commissioner*, 338 F3d 463, 466 (5th Cir. 2003).

# Form 5471 *Foreign Corps.*

- U.S. citizens and residents (including entities) who are officers, directors, or shareholders in controlled foreign corporations may need to file Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*. *See* I.R.C. §§ 6038, 6046.
  - Officer or director if there are certain 10% changes in ownership
  - Control person in a CFC for at least 30 days
  - Shareholders with certain 10% ownership changes
  - 10% or more owners with "U.S. shareholders" owning more than 50% of the shares

# Form 5471 *Foreign Corps.*

Category 1:

- "U.S. shareholder" of a foreign corporation that is a section 965 specified foreign corporation at any time during any tax year of the foreign corporation, and who owned that stock on the last day in that year on which it was an SFC.
- SFC includes a CFC, or any foreign corporation with a U.S. shareholder.
- PFICs are not SFCs as long as the FC is not also a CFC.
- Generally only needs to be filed if there is accumulated E&P or previously taxed E&P related to Section 965

# Form 5471 *Category 2*

Category 2:

- A citizen or resident who is an officer or a director of a foreign corporation in which a U.S. person has acquired:
  - A 10% stock ownership interest in a FC
  - An additional 10% or more of the outstanding stock of the FC

- Includes a U.S. person who has an unqualified right to receive the stock even though the stock hasn't been issued.

# Form 5471 *Category 3*

Category 3:

- A U.S. person (defined below) who acquires stock in a foreign corporation which, when added to any stock owned on the date of acquisition, meets the 10% stock ownership requirement (described below) with respect to the foreign corporation;
- A U.S. person who acquires stock which, without regard to stock already owned on the date of acquisition, meets the 10% stock ownership requirement with respect to the foreign corporation;
- A person who is treated as a U.S. shareholder under section 953(c) with respect to the foreign corporation;
- A person who becomes a U.S. person while meeting the 10% stock ownership requirement with respect to the foreign corporation; or
- A U.S. person who disposes of sufficient stock in the foreign corporation to reduce his or her interest to less than the stock ownership requirement

# Form 5471

*Definitions for Category 2 and 3*

U.S. Person:

- U.S. citizen or resident
- U.S. partnership
- U.S. corporation
- An estate or trust that is not a foreign estate or trust. *See* IRC Section 7701(a)(31)

# Form 5471

*Definitions for Category 1, 2 and 3*

Calculating the 10% Stock Ownership requirement:

- 10% or more of the total VALUE of the FC stock; or
- 10% or more of the total combined voting power of all classes of stock with voting rights.

# Form 5471 *Category 4*

Category 4:

- U.S. Person (different definition) who is in "control" of an FC for at least 30 consecutive days during the year. *See* IRC Section 6038(a)(1).

- U.S. Person Definition: Same as for Cat. 2 except that it also includes:
  - An individual for whom an election is in effect under IRC section 6013(h).
    - Section 6013(h) allows an individual who is a nonresident alien at the beginning of the year, but is a resident at the end of the year, and who at the end of they ear is married to a citizen or resident of the U.S. to elect to file jointly.

# Form 5471 *Category 4*

Control:

- Any time during the year (even one day) the U.S. person owns:
  - More than 50% of the total VALUE of the FC stock; or
  - 10% or more of the total combined voting power of all classes of stock with voting rights
  - For this purpose control can be either direct, or indirect, or by attribution. *See* Treas. Reg. Section 1.6038-2.

# Form 5471 *Category 5*

Category 5:

- Every "United States shareholder" of a Controlled Foreign Corporation (CFC) is a Category 5 filer.

- A U.S. shareholder is a U.S. person who directly, indirectly, or constructively owns 10% by vote or by value of a foreign corporation.
  - Prior to taxable years beginning before Jan. 1, 2018 only voting control was taken into account

- A CFC is a foreign corporation that on any day of the year has U.S. shareholders that own directly, indirectly or constructively, more than 50 percent of the shares by value, or voting power.

# Form 5471 *More Definitions*

- Foreign Trust: A trust will be a domestic trust only if it meets BOTH the:
  - "control test" *See* Treas. Reg. § 301. 7701 -7(c)(1) and
  - "court test" *See* IRC §§ 7701 (a)(30)(E)(i)

- All other trusts are foreign trusts

- "Court" Test: Satisfied if a U.S. court is able to exercise primary supervision over the administration of the trust.

- "Control" Test: Satisfied if the power to make all "Substantial Decisions" is held by a U.S. person.
  - These powers include investment decisions and the power to litigate or arbitrate claims (and the power to name successor trustees)
  - *See* §7701(a)(30)(E)(ii) and Treas. Reg. § 301 .7701 -7(d)(1 )(ii)

# Form 5471

## *Summary Filing Procedure*

- Even inactive or dormant corporations are required to file
- A summary procedure which requires much less information is permitted for "dormant" foreign corporations. *See* Rev. Proc. 92-70, 1992-2 C.B. 435.

# Form 5471 *Rev. Proc. 92-70*

- Conducted no business and owned no stock in any corporation except another dormant foreign corporation;
- Was not a party to a reorganization, and none of its shares were sold, exchanged, redeemed, or otherwise transferred, except for directors' qualifying shares;
- Did not receive or accrue more than $5,000 of gross income or gross receipts;
- Did not pay or accrue more than $5,000 of expenses;
- Apart from the above two de minimis rules, none of its assets were sold, exchanged, or otherwise transferred;
- Had GAAP-basis gross assets, i.e., not reduced by any encumbrances, not exceeding $100,000;
- Made no distributions; and
- Either had no current or accumulated earnings and profits, or had changes only due to permitted de minimis receipts and expenses, as set forth above.

# Time and Place For Filing

- Attached to the applicable income tax return
- Due at the same time as the tax return including any extensions
- For each FC a separate Form 5471 must be filed
- Each missing or incomplete Form 5471 will incur a separate set of penalties

# Form 5471 *Penalties*

- Penalties I.R.C. §§ 6038(b):
  - $10,000 per foreign corporation
  - Plus a $10,000 per month continuation penalty to a maximum of $50,000
    - Total: $60,000
  - Penalties apply to both a failure to file, or the filing of an incomplete Form 5471

- During audit, the IRS will issue a written request for the taxpayer to file Form 5471 within 90 days. If not filed, then the continuation penalty will apply.

# Form 5471

*Reduction of Foreign Tax Credit. I.R.C. Section 6038(c) Section 6038(c)*

- The amount of foreign taxes paid or deemed paid (other than those deemed paid under §904(c)) by the U.S. person for purposes of determining the foreign tax credit under §901 is reduced by 10%.
- If the U.S. person required to report the information is a corporation, its taxes paid or deemed paid under §960 (with respect to any and all foreign corporations for which such U.S. person was required to file Form 5471 under §6038 for such accounting period) are reduced by 10%.
- Both 10% reductions are increased an additional 5% for each three-month period, or fraction thereof, during the period beyond 90 days after the day on which the IRS mails notice of such failure.
- The amount of the reduction is limited to the greater of $10,000, or the company's income.

# Extended SOL Triggered by Failure to Timely File Foreign Information Forms including Form 5471

- I.R.C. Section 6501(c)(8) as amended by the HIRE Act, provides that if certain information related to foreign transactions is not provided to the IRS then the SOL remains open "with respect to any tax return, event, or period to which such information relates." That is, the SOL is extended for the entire tax return.

- Prior to amendment, I.R.C. Section 6501(c)(8) provided that the SOL only remained open "with respect to any event or period to which such information relates," but not the entire tax return.

- If, however, the taxpayer is able to show the failure to file the required foreign information reporting form was due to reasonable cause and not willful neglect, the extended SOL only applies to the item or items that should have been reported on the foreign information reporting form, and not the entire tax return.

- The SOL extension is applicable not only in the case of the non-filing of the appropriate form, but if the information listed on the form is incomplete. See Temp. Treas. Reg. Section 1.1298-1T (d).

- Effective Date. Returns filed after March 18, 2010, or returns filed on or before that date if the SOL had not already expired.

# First Time Penalty Abatement

- IRS will not use the FTA program to abate International Return penalties including Form 5471. IRM 8.11.5.1(12)

# Form 5471 *Reasonable Cause*

- According to the IRS only the initial penalty, and not the continuation penalty is subject to a reasonable cause defense. IRM 20.1.9.3.5.(2).
  - Query: Is that correct? *See* IRC Section 6038(c)(4)(B). ("the time prescribed under paragraph (2) of subsection (a) to furnish information...shall be treated as being not earlier than the last day on which (as shown to the satisfaction of the Secretary) reasonable cause existed for failure to furnish such information.").

- To demonstrate reasonable cause the taxpayer must show that he exercised "ordinary business care, and prudence." *Congdon v. United States*, No. 4:09CV289, 2011 WL 3880524 (E.D. Tex. Aug. 11, 2011).

- Unlike under IRC § 6664, the Court need not evaluate whether the taxpayers have displayed "good faith" in order to relieve them of liability for international penalties. Rather the Debtors need only establish "reasonable cause" under IRC § 6038(c)(4)(B). *In re Wyly*, 552 B.R. 338, 578 (B.N.D. Tx. 2016).

# Form 5471 *Reasonable Cause*

- The IRM provides various factors to consider to determine whether taxpayer exercised ordinary business care and prudence:

  - Erroneous advice or reliance
  - Unable to obtain records
  - Death, serious illness, or unavoidable absence
  - Ignorance of the law, by itself, is not reasonable cause. However, in conjunction with other factors, it might be. Such other factors to consider include: taxpayer's education, if taxpayer was penalized before, if the taxpayer could not reasonably be expected to know of recent changes in the tax law or forms, and the level of complexity of a tax or compliance issue.

# Form 5471 *Reasonable Cause*

- The fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information and/or refusal on the part of a foreign trustee to provide information for any other reason does not constitute reasonable cause.
- Generally, the most important factor in determining whether taxpayer has reasonable cause and acted in good faith was the extent of taxpayer's effort to report the proper tax liability. Treas. Reg. 1.6664-4(b)(1)
- To claim a reasonable cause exception, the taxpayer must set forth the facts on which he relies in a written statement, signed under penalties of perjury.

# Form 5471 *Reasonable Cause*

Examples of what might be reasonable cause include:

- A spouse may be able to demonstrate reasonable cause in relying on tax professionals or her spouse even though the other spouse could not reasonable rely on the advice. *In re Wyly*, 552 B.R. 338, 598 (Bankr. N.D. Tex. 2016) citing *Reser v. Commissioner,* 112 F.3d 1258 (5th Cir. 1997) in which the Fifth Circuit stated that it would be "absurdly inconsistent" to hold that an innocent spouse who had no actual knowledge or reason to know of a tax liability caused by her husband's actions did not also have reasonable cause in relation to penalties caused by those same actions.

- The Fifth Circuit reached this conclusion in part on the basis that a spouse who did not know that the professional advice she relied on was based on incorrect facts provided by her husband could still rely on that advice, especially when that advice was regarding complicated tax law. There was no indication in the Fifth Circuit's reasoning that it was important whether the wife relied on this advice on her own or "through her husband," and the court's admonition against punishing the wife based on the hollow act of asking her husband or the accountants questions would be inconsistent with a need for direct reliance. Id at 1272.

# IRM PENALTY ABATEMENT DECISION TREE

For Late Filed Form 5471 (IRM Exhibit 21.8.2-1)

Robot Analysis

(Similar Decision Tree Available for Form 5472. IRM Exhibit 21.8.2-2)

Brager Tax Law Group

Tax Controversy Law
Tax Controversy Law
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1. Is the taxpayer's request based on a frivolous position?

If Yes – Deny If No – Continue

2. Is the taxpayer claiming they are first time filer and were unaware of the filing requirement?

If Yes- Deny If No – Continue

(IRM notes – don't confuse with FTA on primary return)

(IRM notes – Ordinary business care and prudence requires the taxpayer to determine their tax obligations when establishing a business in a foreign country)

3. Is the taxpayer requesting that the penalty be waived because of financial problems?

If Yes – Deny If No – Continue

# IRM PENALTY ABATEMENT DECISION TREE (Cont.)

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Tax Controversy Law

4. Is the taxpayer claiming that the return was filed late because the transactions, laws or business structure was complicated?

If Yes – Deny If No – Continue

5. Is the taxpayer claiming that because the corporation was involved in multiple layers of ownership, it prevented them from filing timely?

If Yes – Deny If No – Continue

6. Is the taxpayer claiming that the return was filed late because of difficulty in obtaining foreign information?

If Yes – Deny If No – Continue

7. Is the taxpayer asserting that Form 5471 is not required to be filed for the foreign corporation?

If yes – Refer to Exam If No – Continue

# IRM PENALTY ABATEMENT DECISION TREE (Cont.)

- *Additional factors evaluated in the decision tree*
  - Casualty or Disaster
  - Did the taxpayer file returns, or required forms, within a reasonable time after the disaster ended?
  - Death, Serious Illness, or Absence
    - Note. Serious Illness etc. of CPA, employee, or other person not having the sole authority to sign the return will not be deemed reasonable cause
  - Extensions
  - Ignorance of the law.
    - Deny
  - Records unobtainable
  - Reliance

# Decision Tree Reliance Error
# (No wonder most cases will go to Appeals)

- *Was the taxpayer's reliance reasonable?*

| | |
|---|---|
| 1. Reliance involved avoidance of substantial income | Deny |
| 2. Reliance was based on frivolous positions | Deny |
| 3. Taxpayer substantially changed filing patterns | Deny |
| 4. Taxpayer did not take reasonable steps to investigate | Deny |
| 5. Taxpayer did not request a 2nd opinion | Deny |

# Decision Tree Reliance Error
# (No wonder most cases will go to Appeals)

- Who did the taxpayer rely on?

| | |
|---|---|
| 1. Responsible Officer/partner | Continue |
| 2. CPA or Accountant | Continue |
| 3. Attorney | Continue |
| 4. IRS Employee | Go to IRS – Error |
| 5. Bookkeeper | Deny |
| 6. Person assisting in establishment of Foreign Corporation | Deny |
| 7. Information in tax plan or promotion | Deny |
| 8. Financial Advisor | Deny |
| 9. Business Associate | Deny |
| 10. Someone else | Deny |

# Form 5471

## *Substantial Compliance*

- If the person who filed the return establishes that it has substantially complied then the omission or error shall not constitute a failure. Treas. Reg. § 1.6038-2(k)(3)(ii).
- Facts and Circumstances Test. CCA 200429007(July 16, 2004). This CCA was issued in regard to Form 5472 but the analysis should also apply to Form 5471. LB&I International Practice Service Process Unit – Audit (Failure to File the Form 5471 – Category 4 and 5 Filers – Monetary Penalty).
  1) The magnitude of the underreporting, or of the over-reporting, of the erroneous reported transaction(s) in relation to the actual total amount of that reported type of transaction(s);
  2) Whether the reporting corporation has reportable transactions other than the erroneous reported transaction(s) with the same related party and correctly reported such other transactions;
  3) The magnitude of the erroneous reported transaction(s) in relation to all of the other reportable transactions as correctly reported;
  4) The magnitude of the erroneous reported transaction(s) in relation to the reporting corporation's volume of business and overall financial situation;
  5) The significance of the erroneous reported transaction(s) to the reporting corporation's business in a broad functional sense;
  6) Whether the erroneous reported transaction(s) occur(s) in the context of a significant ongoing transactional relationship with the related party; and
  7) Whether the erroneous reported transaction(s) is (are) reflected in the determination and computation of the reporting corporation's taxable income

# Delinquent International Information Submission Procedures. Who Qualifies?

- Not under a civil examination or a criminal investigation by the IRS, and
- Have not already been contacted by the IRS about the delinquent information returns
- Has reasonable cause for the failure to file

# Delinquent International Information Submission Procedures

- A statement of reasonable cause with a statement of all facts establishing reasonable cause for the failure to file must be submitted.
- Must include a certification that the entity for which the return is being submitted did not engage in tax evasion.
- Old FAQ 18 [2012 OVDP]. A taxpayer who has failed to file tax information returns, such as Form 5471 for controlled foreign corporations (CFCs) or Form 3520 for foreign trusts but who has reported, and paid tax on, all their taxable income with respect to all transactions related to the CFCs or foreign trusts, could file delinquent information returns. No penalty.
- C.f. Former OVDP FAQ 32 and 35 excluding from penalties, accounts and assets which generated no gross income.
- All delinquent international information returns other than Forms 3520 and 3520-A should be attached to an amended return and filed according to the applicable instructions for the amended return.

# Don’t File Delinquent Returns?

# Streamlined Procedures

General Eligibility Requirements:

- Only for individual taxpayers, including estates of individual taxpayers
- The failure to file FBARs, the failure to report all income, and the failure to submit all required information returns must be "non-willful."
- Not available to taxpayers who are currently under audit, or criminal investigation by the IRS
- Taxpayers who have submitted full voluntary disclosure letters under OVDP after June 30, 2014 are not eligible
- Taxpayers who have finalized form 906 under prior OVDPs are not eligible

# Non-willful

- U.S. v. Brian Nelson Booker, 19 Cr. 60152 (S.D. Fl. 2020)
  - CPA indicted for submitting a false streamlined application on his own behalf.

# Streamlined Procedures (Cont.)

The Benefits:

- Only three years of tax returns need to be filed vs. eight for former OVDP
- 5% offshore penalty for domestic taxpayers
- No offshore penalty for non-resident taxpayers
- No international reporting form penalties for all taxpayers
- No accuracy related penalty
- No FBAR penalties

# Streamlined Foreign Offshore Procedures (SFOP)

- Eligibility:
  - Must meet the general eligibility provisions for all taxpayers
  - Meet the applicable non-residency requirements
    - For joint filers both spouses must meet the non-residency requirements

- Non-residency requirements applicable to U.S. citizens and green card holders.
  - In any one of the three most recent prior years for which the return due date (or extended return due date) has passed, the individual did not have a U.S. abode, AND
  - The individual was outside of the U.S. for at least 330 full days
    - IRC Section 911 applies for the purposes of these procedures

# Streamlined Domestic Offshore Procedures (SDOP)

- Eligibility:
  - Must meet the general eligibility provisions for all taxpayers
  - Have "previously" filed a U.S. tax return (if required) for each of the most recent 3 years for which the U.S. tax return due date (or properly applied for extended due date) has passed.
    - Thus non-filers are ineligible for the SDOP (unlike SFOP or the former OVDP)

# Streamlined Domestic Offshore Procedures (cont.)

- Scope and effect:
  - A 5% one-time miscellaneous offshore penalty
  - Qualifying taxpayers will not be subject to FBAR penalties, late filing penalties, accuracy penalties, information return penalties.
  - Qualifying taxpayers must:
    - File amended or original tax returns for the past 3 years including all required information returns such as Form 5471, 3520, and 8938
      - The full amount of the tax and interest due must be submitted with the returns
      - The full amount of the 5% offshore penalty must also be submitted with the returns
      - There is no apparent provision for payment arrangements unlike under the former OVDP
      - If the taxpayer has PFICs the modified mark to market method of calculating tax is not available as it would be under the former OVDP
    - Electronically file six years of FBARs
    - Complete the Certification by U.S. Person Residing in the U.S. for SDOP on a form provided by the IRS
    - The Certification must include a statement that the failure to report all income, pay all tax, and submit all required information returns including FBARs was due to non-willful conduct
    - The Certification must set forth "specific reasons" for the failure to report etc.

# SDOP: Calculating the 5% Penalty

- The penalty is 5 percent of the highest aggregate balance/value of the taxpayer's foreign financial assets that are subject to the miscellaneous offshore penalty during the years in the covered tax return period and the covered FBAR period
- The highest value is calculated using year end values
- A foreign financial asset is included in a given year in the covered FBAR period if the asset should have been, but was not, reported on an FBAR
- A foreign financial asset is subject to the 5-percent miscellaneous offshore penalty in a given year in the covered tax return period if the asset should have been, but was not, reported on a Form 8938 for that year.
- A foreign financial asset is also subject to the 5-percent miscellaneous offshore penalty in a given year in the covered tax return period if the asset was properly reported for that year, but gross income in respect of the asset was not reported in that year.

# Appeal Division Consideration

- The Taxpayer should be given an opportunity for a post-assessment, but pre-payment forum for their case to be heard by the IRS Appeals Division. IRM 8.11.5.1(1); IRM 5.8.5.2(4).
- Collection Activity - While the case is in Appeals, it's the taxpayer's responsibility to communicate with the Collection function about the status of their case in Appeals. IRM 5.8.5.1(9)
- The Appeals Officer will assist a taxpayer in providing a collection contact person if the Taxpayer receives collection notices, and a collection employee has not been assigned to the Taxpayer's case. Id.
- The authority to settle appeals of assessed penalties is consistent with the authority to settle all other issues in Appeals. IRM 8.11.5.1 (6).
- Appeals considers applicable statutory, regulatory, and judicial guidance relating to the specific penalty. Appeals may also consider the "hazards of litigation" when resolving International penalty cases. IRM 8.11.5.1 (12).

# Litigation

- Form 5471 penalties are assessable, i.e. generally no right to Tax Court review
  - No right to a prepayment judicial forum
- Exception: Collection Due Process Hearings. See Flume v. Comm'r of Internal Revenue, T.C. Memo. 2017-21 (2017).
  - The taxpayer has 30 days to file a request for a CDP hearing after the mailing of a CDP Notice under IRC Sections 6630 or 6320
  - An Appeals CDP hearing is available to dispute the correctness of a liability if there has been no prior "opportunity" for Appeals Division review
  - If the taxpayer disagrees with the result of the appeals hearing then the taxpayer may file a Petition in the Tax Court
  - Key question: Was there an opportunity for review?
  - Non-receipt by the taxpayer will establish lack of opportunity

# Litigation (cont.)

- International Penalties Subject to Deficiency Procedures. See IRM 5.8.11.5.1(4)
  - IRC 6038(c) – Penalty of Reducing Foreign Tax Credit Plus Continuation Penalty
  - IRC 6038A(e) – Noncompliance Penalty for Failure to Authorize an Agent or Failure to Produce Records
  - IRC 6038C(d) – Noncompliance Penalty for Foreign Related Party Failing to Authorize the Reporting Corporation to Act as its Limited Agent
  - IRC 6039F(c) – Taxability of Gift from Foreign Persons
  - IRC 6686 – Information Returns for Former FSCs
  - IRC 6688 – Reporting for Residents of U.S. Possessions

# Litigation (cont.)

- Pay Penalty in Full
- File a refund claim
  - Claim must be filed with three years of tax return due date, or two years from date of payment
  - Claim should be filed on Form 843
- Sue for Refund in District Court, or the Court of Federal Claims
  - After claim is denied; or
  - Six months after claim is filed if there is neither acceptance nor denial of the claim
  - Suit must be brought no later than two years after the "Notice of Claim Disallowance" is issued
- The Bankruptcy Court has jurisdiction to determine the amount of any international tax penalty. *In re Wyly*, 552 B.R. 338, 356 (Bankr. N.D. Tex. 2016).
- An innocent spouse defense is not available as to an international tax penalty because it is not an income tax liability. *In re Wyly*, 552 B.R. 338 (Bankr. N.D. Tex. 2016).

# Brager Tax Law Group


**Los Angeles**

11400 W. Olympic Blvd., Suite 750
Los Angeles, CA 90064
Phone: 310.208.6200
Toll Free: 800.380.TAX LITIGATOR
Fax: 310.478.8030

www.bragertaxlaw.com
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