

# Tax Penalties & Drafting Your Reasonable Cause Statement

**TRN**  
TAX REP NETWORK

# Penalty Policy Considerations

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

# Penalty Policy Considerations

Generally, relief from penalties falls into four separate categories. Unless otherwise specified in IRM 20.1, penalty relief will be considered and applied, if criteria are met, in the following order:

- A. Correction of IRS error
- B. Statutory and Regulatory exceptions
- C. Administrative waivers, such as First Time Penalty Abatement (FTA)
- D. Reasonable cause

*Example, if a request for Reasonable Cause is submitted by the taxpayer and that tax year qualifies for FTA, then the abatement is coded as an FTA.*

# First Time Abatement

- IRS allows a first time penalty abatement for failure to file and failure to pay penalty
- See IRM 20.1.1.3.3.2.1 (03-29-2023)
- IRS provides administrative relief from the following penalties if the qualifying criteria contained in this subsection are met:
  - Failure to file (FTF) penalty under IRC 6651(a)(1), IRC 6698(a)(1), or IRC 6699(a)(1),
  - Failure to pay (FTP) penalty under IRC 6651(a)(2) and/or IRC 6651(a)(3), and
  - Failure to deposit (FTD) penalty under IRC 6656.



# First Time Abatement

- This administrative waiver, implemented in 2001, is referred to as First Time Abate (FTA) and is available for penalty relief the first time a taxpayer is subject to one or more of the referenced penalties for a single return. When FTA criteria have otherwise been met, do not provide penalty relief under the FTA waiver unless the following are true:
  - ~~The taxpayer has filed, or filed a valid extension for, all required returns currently due, AND~~
  - ~~The taxpayer has paid, or arranged to pay, any tax currently due.~~
- Does not apply to anything prior to 2001!

# First Time Abatement

The Internal Revenue Manual (IRM) section concerning First Time Abatement (FTA) was most recently updated on March 29, 2023.

Notable changes from prior IRM version:

- The taxpayer is no longer required to be in filing compliance (current plus prior 5 years of tax returns).
  - However, the taxpayer must have filed an original return for the year FTA is being request AND the prior 3 years (look back period) if there is a filing requirement.
- The taxpayer is no longer required to be in an agreement to pay if there is an outstanding balance due.

# Critical Considerations

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

IRS ACCOUNT STATUS DASHBOARD

Year	Return Filed	Filing Status	Extension Date	Lien Active	Collections Active	Examination Active	Assessed Balance	Accrued Balance	Transcript Date
2020	No	S					\$0.00	\$0.00	7/1/2020
2019	No	S					\$0.00	\$0.00	7/1/2020
2018	Original	MFJ	10/15/2019		4/22/2020	4/27/2020#	\$269,636.55	\$278,353.58	7/1/2020
2017	Original	MFJ	10/15/2018				\$0.00	\$0.00	7/1/2020
2016	Amended	MFJ	10/15/2017			Closed	\$0.00	\$0.00	7/1/2020
2015	Amended	MFJ	10/15/2016			Closed	\$0.00	\$0.00	7/1/2020
2014	Amended	MFJ	10/15/2015			Closed	\$0.00	\$0.00	7/1/2020
2013	Original	MFJ	10/15/2014				\$0.00	\$0.00	7/1/2020
2012	Original	MFJ	10/15/2013			Closed#	\$0.00	(\$0.73)	7/1/2020
2011	Original	MFJ	10/15/2012				\$0.00	\$0.00	7/1/2020
2010	Original	MFJ	10/15/2011			Closed	\$0.00	\$0.00	7/1/2020
2009	Original	MFJ	10/15/2010				\$0.00	\$0.00	7/1/2020
2008	Original	MFJ	10/15/2009	Removed			\$0.00	\$0.00	7/1/2020
2007	Original	MFJ	10/15/2008				\$0.00	\$0.00	7/1/2020
2006	Original	MFJ	10/15/2007				\$0.00	\$0.00	7/1/2020
2005	Original	MFJ	10/15/2006			ASED exp	\$0.00	\$0.00	7/1/2020
2004	Original	MFJ	10/15/2005				\$0.00	\$0.00	7/1/2020
2003	No	S					\$0.00	\$0.00	7/1/2020
2002	Original	MFJ	10/15/2003				\$0.00	\$0.00	7/1/2020
2001	Original	MFJ	10/15/2002				\$0.00	\$0.00	7/1/2020

\*exception: estimated tax penalty

# Ooops.....

## PENALTY AND INTEREST DASHBOARD

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



# Strategies for Exam

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



# Strategies for Appeals

Appeals will not  
simply concede

Use it as a bargaining  
chip

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

# Appeals

- ▶ Won't just concede because of the policy considerations
- ▶ Argue for conceding but request the abatement
- ▶ Make sure to point out factors that support your argument:
  - a. Client actually incurred the expense
  - b. Client hired a competent-appearing professional
  - c. Client provided all info and was attempting to comply
  - d. Client has a good history

## Reasonable Cause - *Appeals*

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

# Reasonable Cause - Appeals



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



# Practice Tips

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

# Reasonable Cause

Use Form 843

Request abatement

Document your case

Appeal (# of days to appeal depends on who issued the denial)

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

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

## Reasonable Cause - *Failure to File/Pay*

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

# Example

- Taxpayer files 8 years of late returns ('03-'10)
- Daughter had brain cancer in '05 at age 16, has surgery and recovers in '06
- Older brother and daughter both out of the house now and graduated from college
- Owes \$145,000 for the unfiled years, plus penalties and interest
- Wants to seek penalty relief, which should be easy like they say on late night TV commercials

# Example

- She sends us lots of medical documentation
- Consider
  - Could the non-compliance have been avoided
  - T/P's History
  - Does the story fit
  - What about the medical documentation?



## Now Consider This

- Husband is self-employed financial professional
- Two small children
- Wife is bi-polar and becomes suicidal after second child is born in '04
- Ceases filing and paying his taxes for '04-'05
- Owes \$62,000 of tax plus penalties and interest
- Sends medical documentation for his wife, who is now stable

# What is Different Here?

- Brief period of time
- Extreme family situation
- Medical documentation to support the story
- The story fits – non-compliance started immediately after medical crisis, ceased when under control

# Drafting the request

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

## PRACTICE TIP!

- ▶ Make the reviewer's job easy
- ▶ Give them what they need to agree with you
- ▶ Do NOT expect them to go searching for information to help you
- ▶ Understand they are working remotely and limited, so make their decision to agree with you easy

## Reasonable Cause: *Reliance on Tax Advice*



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



# Lindsay vs. US

- ▶ Taxpayer was incarcerated
- ▶ Hired someone to handle his taxes and gave them money
- ▶ Person claimed they were doing what they were supposed to and instead was actually embezzling
- ▶ Taxpayer had no problem communicating back and forth
- ▶ Court refused to abate penalty because taxpayer failed to properly oversee

# IRC § 6751(b)(1)

- ▶ IRC § 6751(b)(1) provides: “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.”<sup>1</sup>
- ▶ IRC § 6751(b)(2) carves out two categories of exception from this supervisory approval requirement: (i) the penalties for failure to file a tax return (IRC § 6651(a)(1)), failure to pay the tax due (IRC § 6651(a)(2)), and failure to pay sufficient estimated tax (IRC §§ 6654 and 6655) and (ii) any other penalty that is “automatically calculated through electronic means.”
- ▶ *Depending on the type of penalty, is it worth going to Appeals to see if the supervisor approval was obtained?*

# Questions?

