What Do I Do When I Miss a Deadline?

TAX UPDATE AND PLANNING CONFERENCE

NOV. 24-25, 2014

SAN FRANCISCO | UNIVERSAL CITY | WEBCAST

TAX LAW OFFICES OF

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Tax Rescue

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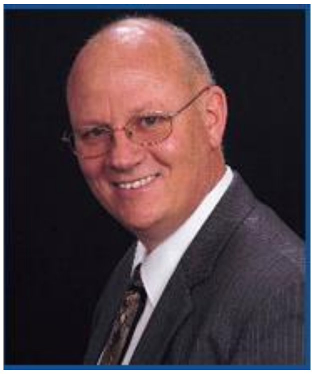

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What Do I Do When I Miss a Deadline?

Taxpayers and tax professionals alike can panic when a deadline is missed. Although not every mistake can be rectified, this session outlines steps you can take to resolve problems caused by a

missed tax return, extension or election filing deadline. You will learn how to: • Analyze the impact of a late filed return or election on a taxpayer's overall tax situation • Identify relief opportunities for missed elections affecting taxable income and entity status • Recognize when penalty relief may be available.

1. Tips to minimize your exposure to malpractice related to tax in general and specifically for missed deadlines:

    a. Understand the elements of the average tax malpractice case:

        i. Tax malpractice cases are ordinarily based on either traditional tort or contract theories.

            1. Under tort law a professional has a duty to exercise the level of skill, care and diligence normally exercised by other members of the profession under similar circumstances.

            2. Under contract law a professional has a duty to perform the task undertaken diligently and competently.

        ii. In practice, these two standards are very similar. The diligent professional, must demonstrate reasonable competence to avoid malpractice exposure. The professional must perform as a reasonably competent and careful professional would perform under similar circumstances. Those with advanced education and experience in tax law may be operating under a higher standard of care. Tax law is a field that has been recognized as requiring the higher level of a "specialist's skill". A specialist is required to perform at a similar level of skill and diligence as others in the same specialty.

    b. Measure of Damages:

        i. Under the tort measure of damages, a plaintiff may recover for all of their injuries that are proximately caused by a defendant's negligent performance. The plaintiff may generally recover the difference between his or her post damages economic position and the position that he or she would have been in had the professional not performed negligently.

        ii. Damages can include indirect or consequential damages that were actually incurred but not merely damages that may arise in the future. Additionally, where a court deems it appropriate, a plaintiff may be entitled to recover punitive or exemplary damages.

        iii. Damages may include additional taxes caused by the malpractice (in certain circumstances), along with interest and penalties. Recoverable additional taxes are limited to solely taxes that could have been avoided had the plaintiff received non-negligent advice. If additional taxes would have been owed, but return preparation errors mislead the plaintiff to believe that less was owed, the additional taxes are non-recoverable as they were not proximately caused by the preparer's malpractice. Beware, a tax practitioner can conceivably be held liable for taxes that were overpaid as a result of a preparer's negligence if the taxes can no longer be recovered from the government by the filing of an amended return.

c. Analyze your firm's exposure to malpractice related to tax and reduce the exposure where possible.

    i. Malpractice claims and litigation costs can quickly strip the accountant of sizable profits and cause reputational damage. Even if you ultimately prevail in the malpractice litigation, or settle the case, you could become known as simply the "accountant who was sued" regardless of the outcome. The wise CPA should always be looking for proactive steps that they can take to help prevent litigation and malpractice claims.

    ii. Background:

        1. Tax preparation and tax consulting result in the largest number of lawsuits against accountants. Tax malpractice results most frequently from simple lapses in judgment or due diligence. Typical tax malpractice claims stem from missed deadlines and elections to poor planning or compliance advice and return preparation errors. Malpractice more often results from simple inattentiveness accompanied with poor client communications than from errors due to the complexities of the tax code. Many problems can be prevented by simple quality control procedures, such as an adequate tickler system.

2. Tips to avoid tax malpractice:

    a. Be careful when giving spur-of-the-moment tax advice. If your client calls during the rush of tax season with a "quick question," take a moment to evaluate if the question is easy enough, and the client sophisticated enough, that you will be able to answer the question competently without taking the time to research the issue. If you do proceed with giving "quick advice," dictate a file memo summarizing the advice. If your client is unsophisticated and/or the question is complex – or if large dollars are involved – confirm the advice with a short letter summarizing the information you were given, the advice you gave, and remind the client that it was a quick general discussion, and invite the client to discuss the matter in more detail with you when time permits.

    b. Especially where large tax liabilities are at stake, computations should be checked by a second and possibly a third reviewer.

    c. Regularly meet with staff to discuss the status of all tax projects and to the extent possible eliminate specific deadlines and tax projects from falling through the cracks.

    d. Ask every client to review their returns for accuracy and offer to fix any errors for free. This puts the taxpayer in the last clear position to remedy any problems with the returns. In a comparative negligence jurisdictions this will result in an allocable share of the negligence being allocated to the client, thus reducing proportionately the damages assessed on the preparer.

e. Communications with Clients:

   1. Document all client meetings and telephone communication.

   2. Obtain the client's express consent and approval before filing extensions and elections.

   3. Inquire often about the existence of any non-routine transactions.

   4. Request copies of executed documents after large financial transactions and keep a running issue list for tax planning and preparation purposes.

   5. When tax positions or elections have a substantial chance of being disallowed or challenged, inform the client of the potential in writing. Make sure your client is well informed in writing and attempt to make the client the final decision maker on any high-risk issues in writing.

   6. Provide written instructions to clients on filing deadlines.

   7. Request client information sufficiently ahead of filing deadlines in writing. If the information is late, write the client another memo warning of the looming deadline and the consequences of their non-performance.

f. Billing:

   1. Collect delinquent bills before renewing client engagements and consider taking a retainer for repeat offenders. Don't routinely get paid this year for last year's work.

   2. Do not sue clients for nonpayment as this is the single fastest way to draw a counter mal practice claim.

g. Be careful when preparing last-minute extensions based upon what a client has told you but not confirmed in writing. It's easy during tax season to forget unusual items that should be included when calculating the extension payment. Document your discussions with your client and confirm in writing that the extension is based upon and only as good as the information provided by the client.

h. The best practice is to make sure you have all the facts before you give sensitive tax advice. Tell the client you need more time and/or more facts before you can be in a position to give advice. Do not let the client rush you. If the engagement involves an unfamiliar area of law, consider consulting with a specialist.

i. Client acceptance procedures:

i. Discuss and document client goals on each individual engagement and avoid open-ended relationships with clients.

ii. Inquire about past litigation with accountants, attorneys, financial advisors business partners or tax collectors. Avoid over litigious clients at all cost.

iii. Assess a client's attitudes toward law, regulations and deadlines.

iv. Be on the lookout for clients that are in divorce proceedings or in estate disputes with family members as they may exhibit volatile behavior and mood swings.

v. If possible speak frankly with prior accountants or legal counsel.

j. Clarify your responsibility for deadlines with your client via clear and concise engagement letters:

1. Be contractually clear on what your firm's responsibilities are and what your client's responsibilities are:

   a. Write engagement letters for each project limiting the engagement to a single year of work;

   b. Delineate professional services that are to be performed by other advisers if known;

   c. Identify tax or information reporting that is not covered by the engagement, such as state, payroll, or property taxes;

   d. Do not recommend individual investments unless you are a registered investment adviser.

2. Provide your client cut off deadlines and include CYA language:

   a. Simplified Example:

      i. You must have all of the information necessary to prepare your corporate return to us by 3/1/15 or we may have to extend your 2014 return. In order to extend your 2014 corporate return we will need you to provide us all of the information necessary to fully complete your return or alternatively to estimate your tax liability by 3/10/15 or we will be filing a zero balance due corporate extension on 3/15/15. Any penalties and interest related to late payment of balances due or subsequent estimated tax payments rests with you where we prepare estimates and extension payments from data that you approve and based on estimated net income that you approve.

ii. Use practice management software to tracks deadlines:

1. It is critical that tax and information return deadlines are scheduled accurately and managed timely. There are several Practice Management Software packages available to CPA's that track client data, employee time, outstanding projects and their associated deadlines. Partners and owners and firm management and responsible staff are able to see data (including pending deadlines) in real-time as time data is entered, projects are completed and client invoices are processed.

   Practice management software facilitates the tracking of individual projects which can be subdivided into multiple tasks, and assigned to individual staff members, review staff and partners. Workflow steps and due dates can be assigned and as work progresses on the individual projects, at the completion of a task, the appropriate users in the next workflow step are automatically notified and the next task may be started.

2. Consider looking at the following software packages:

   a. CCH - ProSystem fx Practice Management
   b. Commercial Logic APS Advance Practice Management
   c. Credenza Software for Practice Management
   d. Deltek Maconomy Public Accounting Solution
   e. Office Tools Professional Practice Management 2013
   f. Thomson Reuters Practice CS

3. Actions you should consider taking if you are sued:

   a. Do not bury your head in the sand or ignore the situation. Your inaction can make the situation exponentially worse and negatively affect your ability to defend against the suit.

   b. Don't attempt self-help including trying to talk the client or his counsel out of suing you. Anything you say to either of them can and will be used against you in the litigation to follow. Be careful with any conversations you have or documentation you create that relates to the litigation as it is discoverable.

   c. Do not pull an Arthur Anderson and destroy documents. Document destruction is a crime in certain circumstances and will turn a jury against you.

   d. Don't augment your workpapers with what your current recollection of what was done. Workpapers are ordinarily contemporaneous documents and you could undermine their use as a defense tool. They can be used to refresh your memory at trial and be effective in convincing a jury that you were competent. Without them, you'll have to convince the jury with solely your unsupported hindsight testimony.

e. Notify your insurance carrier as soon as you sense there may be a malpractice claim, in the precise manner called for in the policy. If you delay too long, your malpractice coverage might be denied.

f. Consider hiring a qualified lawyer so that the attorney-client privilege can be used to protect the subsequent communications and associated work product in preparation for litigation. Otherwise, preparation for the upcoming litigation may be discoverable.

4. Analyze the impact of a late filed return or election on a taxpayer's overall tax situation:

   a. Partnership penalties for late filing:

      i. If a partnership fails to file a return on time or fails to include all the information required to be shown on the return, the partnership is subject to a penalty of $195 for each month or fraction of a month the failure continues, up to a maximum of twelve months.

      ii. Good faith exception:

         1. Under Rev. Proc. 84-35, a domestic partnership composed of 10 or fewer partners will not be subject to the $195 per month penalty as long as all partners (husband and wife and their estate treated as one partner and partnership cannot have nonresident alien partners) have fully reported their distributive shares of the partnership's income, deductions and credits of the partnership on their timely filed individual income tax returns.

      iii. Failure to timely file a schedule K-1:

         1. A $50 penalty can be assessed for each failure to furnish a Schedule K-1 to a partner that includes all of the required information subject to a $100,000 limit. The $100,000 limit can be increased if the requirement to issue K-1's is intentionally disregarded.

5. Identify relief opportunities and damage control measures for missed deadlines affecting individual taxable income:

   (i) If the taxpayers owes tax and misses a deadline, have the client send in payment for the estimated amount of tax they owe as soon as possible.

   (ii) Write a penalty abatement letter:

      a. Every penalty abatement letter prepared by a tax professional should have the following declaration at the bottom of the letter before the client's signature block:

         i. Under penalties of perjury, I declare that this request was prepared by me and, although I do not know of my own knowledge that the facts contained herein are true and correct, on the basis of the information provided to me, I believe them to be true and correct.

6. Exposure to the CPA over domestic informational returns:

a. Over 30 federal, domestic informational returns exist. Most of these are for IRS "cross checking" purposes to ensure proper individual income tax reporting. Many of them have the same due date, for example, Forms 1097, 1098, 1099, 3921, 3922, and W-2G must be filed by March 2 (or, if filing electronically, March 31), but a 30 day extension applies automatically if Form 8809 (Application for Extension of Time to File Information Returns) is filed.

   i. Section 6721 provides penalties for any failure to file correct information returns by the due date. The penalty varies with the delinquent filing date of the corrected information return.

      1. If you file the corrected return within 30 days then a $30 penalty applies per return (but not to exceed $250,000; and not to exceed $75,000 if it is a "small business"). The date is March 30 for a February 28 deadline.

      2. If you file the corrected return after the 30 day window, but before August 1, then the penalty is $60 per return (but, again, not to exceed $500,000; and not to exceed $200,000 if it is a "small business").

      3. If you file the corrected return after August 1 (or if you fail to file informational returns) then the penalty is $100 per return (but not to exceed $1.5 million per year; and not to exceed $500,000 for "small businesses").

b. There are certain notable exceptions to the above penalty structure:

   i. Reasonable cause exception. The penalty does not apply if your failure to file was the result of a reasonable cause and not due to your willful negligence. This typically means you must prove there was an event beyond your control that explains your failure to file and that you acted reasonably and responsibly.

   ii. Inconsequential error or omission exception;

      1. The penalty does not apply if there is an inconsequential error (or omission). In other words, a taxpayer is not deemed to have failed to include correct information if he or she files a return that contains inconsequential errors or omissions. When a return contains an inconsequential error it does not prevent the IRS from processing it, cross checking it with other information, and the like. However, an incorrect TIN, taxpayer's last name, or reportable income are not inconsequential error or omissions.

   iii. De minimis exception:

      1. The penalty does not apply if you filed a return with certain required but incorrect information (or omitted information) and you filed a correction before August 1. This exception is available even if you cannot prove you had a reasonable cause for your non-filing. How available is this exception? You may use this exception for the greater of 10 informational returns or 50% of 1% of the total returns required to be filed for the year.

7. Recognize when penalty relief may be available via an IRS program:

    a. For example:

        i. New Penalty Relief Program for Form 5500-EZ Late Filers;

            1. A new pilot program gives sponsors and administrators of retirement plans not covered by Title I of ERISA automatic relief from IRS late filing penalties on past due:

                a. Form 5500-EZ, Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan, or

                b. Form 5500, Annual Return/Report of Employee Benefit Plan, if you must file this return because your non-ERISA plan doesn't meet the filing requirements for Form 5500-EZ for plan years before 2009.

            2. A plan is not eligible for relief under the pilot program for any year that it was subject to Title I of ERISA. In that case penalty relief for these years should be pursued through the Department of Labor's

        ii. Other examples:

            1. 2012 OVDI
                a. Streamlined
                b. Late filing of foreign information return with penalty abatement request

            2. Voluntary worker classification settlement program

8. Recognize when penalty relief may be available via the tax code:

    a. Congress legislated in relief provisions into the tax code where it wisely anticipated that taxpayers could face penalties for circumstances that were beyond their control. Consequently, the vast majority of the civil penalties available to the IRS provide for penalty abetment where the performance required by the tax code was not rendered as a result of "reasonable cause". However, several of the civil penalties have additional requirements on top of a finding of reasonable cause before they can be abated.

    b. For example:

        ii. To successfully abate a § 6651 failure to file or failure to pay penalty, the taxpayer must additionally show that the failure was not due to willful neglect.

        iii. To abate an accuracy-related penalty under § 6662 or § 6662A, the taxpayer must additionally establish that they acted in good faith.

iv. Under Code Sec. 6664(c), the Code Sec. 6663 fraud penalty can be abated as to any portion of an underpayment where it can be demonstrated that the taxpayer had reasonable cause for the underpayment and acted in good faith.

1. Good Faith / Absence of willful neglect:

a. Whether a taxpayer acted in good faith is a facts and circumstances determination made on a case-by-case basis. Under Reg. §1.6664-4(b), the single most important factor is the level of effort demonstrated by the taxpayer to assess the proper tax liability. Taxpayers are required to perform with ordinary business care and prudence which is shown where they utilize the degree of care that a reasonably prudent person would exercise in attempting to assess the proper amount of tax liability.

b. In some instances, taxpayers may not be aware of tax requirements. Ordinary business care and prudence requires that taxpayers make reasonable efforts to determine their tax obligations. However, ignorance of the law combined with other facts and circumstances, such as limited education or the lack of previous tax and penalty experience, may support a reasonable cause waiver (Reg. §1.6664-4(b)). An isolated computational or transcriptional error is not inconsistent with reasonable cause and good faith (Reg. §1.6664-4(b).

c. Good faith is defined as an honest belief, in the absence of knowledge or evidence of circumstances that would put a taxpayer on notice that they are under a duty of additional inquiry, and free of any intention to defraud.

d. Willful neglect is defined as a conscious, intentional failure or reckless indifference.

i. If any portion of an underpayment is attributable to a Reg. §1.6011-4(b) reportable transaction, then the failure by the taxpayer to disclose the reportable transaction, is a near irrefutable indication that the taxpayer failed to perform in good faith with regards to the allocable portion of the underpayment directly attributable to the reportable transaction under Reg. §1.6664-4(d).

c. Reasonable cause for the failure:

i. Requirements for the reasonable cause exception to apply:

1. Ultimately, a taxpayer justifies a reasonable cause abatement when his or her conduct justifies the non-assertion or abatement of the complained of penalty or penalties. Relief is ordinarily granted when a taxpayer is able to satisfactorily demonstrate that he or she exercised ordinary care and

prudence in reporting his or her tax obligations, but because of circumstances beyond their control was prohibited from complying with their tax obligations.

2. Ordinary business care and prudence requires a taxpayer to provide for his reasonably foreseeable obligations. A taxpayer may establish reasonable cause by showing that he exercised ordinary business care and prudence, taking the degree of care that would be exercised by a reasonably prudent person, but nevertheless was unable to comply with the law.

3. The taxpayer also must be able to demonstrate that, despite his or her exercise of ordinary business care and prudence, he or she was rendered unable to meet his or her tax responsibilities.

    a. IRM 20.1.5.14.8 (01-24-2012) circumstances that may indicate reasonable cause and good faith because the taxpayer exercised ordinary business care and prudence;

        i. Honest misunderstanding of fact or law that is reasonable given the experience, knowledge, sophistication and education of taxpayer.

        ii. An isolated computational or transcription error.

        iii. Reliance on erroneous information reported on Forms W-2, 1099, etc., provided that the taxpayer did not know or have reason to know that the information was incorrect.

        iv. Reliance on advice of a tax advisor or appraiser who does not suffer from a conflict of interest or lack of expertise.

    b. IRM 20.1.5.14.8 (01-24-2012) circumstances that may not indicate reasonable cause and good faith because the taxpayer did not exercise ordinary business care and prudence;

        i. Lack of significant business purpose.

        ii. Reliance on advice of a tax advisor or appraiser who the taxpayer knows or should have known lacked sufficient expertise or lacked independence.

        iii. Taxpayer agreed with the organizer or promoter of the tax shelter that the taxpayer would protect the confidentiality of the tax aspects of the structure of the tax shelter.

        iv. Taxpayer engaged in transactions that lacked economic substance after 3/31/10.

        v. The taxpayer claimed tax benefits that are unreasonable in comparison to the taxpayer's investment in the tax shelter.

vi. Nondisclosure of a reportable transaction.

4. Reasonable cause is never statutorily presumed. It must be demonstrated by the taxpayer based on a facts and circumstances analysis. In determining if the taxpayer exercised satisfactory ordinary business care and prudence, the IRS reviews all available information and asks the following questions.

   a. What are the taxpayer's reason for not complying with the law that led to the imposition of a penalty?

   b. What are the facts and circumstances prevented the taxpayer from complying?

      i. How did they prevent the taxpayer from complying?

      ii. When did these facts and circumstances occur?

         1. Do the dates clearly correspond to the events on which the penalty is based?

   c. Should the taxpayer have reasonably anticipated the events that caused his or her noncompliance?

      i. Could the taxpayer reasonably have foreseen and avoided the occurrence of the event or have planned for it?

   d. How did the taxpayer handle the rest of his affairs during the time of the noncompliance?

   e. Once the facts and circumstances changed that prevented compliance, what attempt did the taxpayer subsequently make to comply with his obligation and did they do so timely?

      i. How much time elapsed between the end of the event cited as the reason for noncompliance and his subsequent compliance?

   f. What is the taxpayer's overall compliance record?

      i. Has the same or a similar penalty previously been assessed or abated?

   g. Where a taxpayer demonstrates that, because of incompetence or infirmity, he or she is unable to meet the standard of ordinary business care and prudence, there is no reason for the IRS to impose a penalty.

5. Causation and duration:

a. To qualify for a penalty waiver, the events put forth as constituting reasonable cause must be directly connected to the taxpayer's so that they cause the failure to comply and must continue throughout the failed performance period.

b. If either causation or duration is lacking, the penalty applies, at a minimum, as to that period. The longer the delay, the more likely it is that the IRS will impose a penalty.

d. Grounds that establish reasonable cause:

i. Reliance on tax advice:

1. Reasonable cause may be argued where a taxpayer reasonably relies on the advice of a competent tax adviser, attorney, CPA or EA. The taxpayer's education, sophistication, and business experience are factored into the determination of whether or not a taxpayer reasonably and in good faith, relied on a tax professional's advice.

a. The following penalties can be abated by arguing reliance on the advice of a tax advisor.

i. The underpayment penalties under § 6662 or under § 6663.

ii. The accuracy-related penalty on understatements related to reportable transactions under § 6662A.

iii. In limited circumstances the reliance on a tax advisor exception may apply to other penalties when the tax advisor provides advice on the substantive tax issue giving rise to the penalty.

iv. Reliance on the advice of a tax advisor is limited to issues that are generally considered technical or complicated.

b. A taxpayer's responsibility to file, pay, or deposit taxes under § 6651 <u>may not ordinarily be excused</u>, (except in a very narrow range of circumstances) by reliance on the advice of a tax advisor exempt in the following limited circumstances.

c. In United States v. Boyle 469 U.S. 241 (1985), the Supreme Court established when reliance on a tax advisor constitutes grounds for reasonable cause abatement concerning a failure to file penalty under § 6651(a). The Court held that a taxpayer cannot avoid the penalty simply by relying on his advisor to file the return.

d. The Supreme Court reasoned that Congress had placed the burden of prompt filing on the taxpayer and that duty was non delegable to an agent or employee of the taxpayer. Therefore the taxpayer in under an obligation to ascertain the statutory deadline and then to meet that deadline.

e. The federal courts are split as to whether a taxpayer's reliance on;

  i. incorrect legal advice as to the need for filing a tax return in the first place;

  ii. or incorrect advice on a return's due date;

    1. constitute reasonable cause for failing to timely file the return for a taxpayer.

  iii. The Tax Court has consistently held that it can.

  iv. Some of other courts agree by distinguishing advice that leads the taxpayer astray as opposed to an impermissible delegation of a duty to file.

  v. Some courts disagree and hold that each taxpayer has a personal, non-delegable duty to timely file his tax returns and that the taxpayer's reliance on erroneous advice is insufficient to constitute reasonable cause for failing to fulfill that duty.

2. In order for reliance on a tax professional to be considered reasonable cause for penalty abatement purposes, the advice must be based on all of the pertinent facts and circumstances and an interpretation of the relevant law as it relates to the stated facts and circumstances. Under Reg. §1.6664-4(c)(1)(i) the taxpayer is required to:

   a. Disclosed all facts that they knew or reasonably should have known, were on point to the tax treatment of an item for which they claim reasonable reliance on a professional.

   b. The advice relied upon cannot be based on unreasonable factual or legal assumptions and must not unreasonably rely on the representations, statements, findings or agreements of the taxpayer or any other person.

   c. Satisfaction of the above two is a prerequisite of a finding of reasonable reliance but does not guarantee such a finding.

3. IRM 20.1.5.6.4 (01-24-2012):

   a. Reliance upon a tax opinion provided by a tax advisor may serve as a basis for the reasonable cause and good faith exception to the accuracy-related penalty. The reliance, however, must be objectively reasonable. For example, the taxpayer must supply the advisor with all the necessary information to assess the tax matter. Similarly, if the advisor suffers from a conflict of interest or lack of expertise that the taxpayer knew about or should have known, the taxpayer might not have acted reasonably in relying on that advisor. The advice also must be based on all pertinent facts, circumstances and the law as it relates to those facts and circumstances.

b. The advice must not be based on unreasonable factual or legal assumptions (including assumptions as to future events) and must not unreasonably rely on the representations, statements, findings, or agreements of the taxpayer or any other person. For example, the advice must not be based on a representation or assumption which the taxpayer knows, or has reason to know, is unlikely to be true, such as an inaccurate representation or assumption as to the taxpayer's purposes for entering into a transaction or for structuring a transaction in a particular manner. Similarly, the advice must not be based on an assumption that the transaction has a business purpose other than tax avoidance.

c. "Advice" is defined as any communication, including the opinion of a professional tax advisor, setting forth an analysis or conclusion by a person other than the taxpayer and on which the taxpayer relied in preparing the return. Advice does not have to be in any particular form.

d. Whether a taxpayer reasonably relied on an opinion or advice cannot be determined without reviewing the opinion. At times, a taxpayer may refuse to turn over an opinion the taxpayer claims to have relied on or the taxpayer may assert a privilege claim. If the taxpayer refuses to provide the opinion, the service will disallow the taxpayer's position as not being verifiable.

e. Whenever the service is considering whether a penalty should be asserted because the taxpayer may have met the "advice" standard under the reasonable cause exception, the IRS will contact the preparer to confirm that the advice was provided, and then finalize a determination if the reasonable cause exception is available before the case is closed. This contact is authorized by IRC 6103(k)(6). The examiner will ordinarily be mindful that the preparer of the return may not be the person who prepared or provided the advice. Contact with both may be necessary.

f. Whenever the return preparer's conduct becomes an issue, the examiner will consider the applicability of the return preparer penalties under IRC 6694 and IRC 6695. See IRM 20.1.6, Preparer, Promoter, Material Advisor Penalties.

4. Miscellaneous case law requirements for penalty abatement based on the erroneous advice of a tax advisor. The taxpayer must show <u>all</u> of the following requirements to establish that such reliance was reasonable.

    a. The advisor was a competent tax professional who had sufficient expertise to justify the taxpayer's reliance on them;

        i. To meet this requirement the tax advisor must be competent with respect to the specific tax matter leading to the penalty. The general wisdom is that sophisticated tax issues require knowledgeable and sophisticated advisors. The taxpayer is thus required to be cognizant of his advisor's qualifications and expertise.

    b. The taxpayer accurately provided all the necessary information to the advisor so the advisor was in a position to provide accurate advice;

        i. The advice that led the taxpayer astray must have been based on all of the relevant facts and circumstances and the relevant law should have been applied to those facts and circumstances. Thus the advice obtained cannot have been based on unreasonable factual or legal assumptions.

    c. The taxpayer must have reasonably relied in good faith on the advice received from the advisor;

        i. The advice must directly address the issue that led to the penalty. The advice must not have been informal and the taxpayer cannot pick and choose from conflicting advice without good reason. The advice must have been obtained timely, and cannot be relied on after the advice is withdrawn or amended.

    d. A taxpayer is likely to be deemed to be "put on notice" that something may be awry with the advice he or she receives where the purported tax benefits to be enjoyed are "too good to be true." Where the tax benefits clearly exceed the cost by a significant margin, the taxpayer is required to ask additional questions.

    e. The advisor must not be the taxpayer;

    f. The advisor must actually render advice and communicate his or her analysis or conclusions to the taxpayer.

    g. A taxpayer may not rely on the advice of a tax advisor who is operating under an inherent conflict of interest.

        i. For example, case law deemed reliance on the advice of a founder or promoter of a tax shelter, and their associated offering materials as unreasonable because of the conflict of interest that is apparent where the advisor's financial stake in the transaction taints his or her objectivity.

h. Where a purported tax benefit turns on nontax factors, the taxpayer is placed under a duty to investigate the underlying nontax factors. The taxpayer is prohibited from simply relying on a promoter’s statements. Additionally, if the tax advisor has no mastery of the nontax factors, mere reliance on the tax advisor / promoter will not suffice.

ii. The taxpayer's history of compliance supports non-assertion of penalties

1. Courts have consistently taken the position that a taxpayer with a consistent and substantial history of being in tax compliance can establish reasonable cause for a late filing or late payment/deposit where it results from an inadvertent and rare human error. Case law shows that at a minimum a taxpayer's past history of substantial tax compliance is a large factor to be considered as to whether an out of character error that led to a late filing would constitute reasonable cause. In one tax court case holding that a penalty was not justified, the Tax Court held in essence that an inadvertent and rare employee oversight error may constitute reasonable cause where returns are filed as soon as the oversight was discovered and the taxpayer had a good reputation for historically meeting its tax bills.

2. Sustaining the penalties and related interest would be inconsistent with the IRS Penalty Handbook

a. In a penalty abatement letter arguing that the taxpayer’s history of compliance supports penalty abatement. Cite the following (see b.) IRS policy behind penalties and then conclude:

i. Because of the facts and circumstances unique to my client’s fact pattern just described, imposing a penalty would not enhance voluntary compliance because the imposition of a penalty is simply not required to correct the taxpayer's behavior as demonstrated by their past compliance record.

b. The IRS Penalty Handbook, IRM 20.1.1.2 (2-22-08) provides that: “Penalties exist to encourage voluntary compliance by supporting the standards of behavior expected by the Internal Revenue Code.” “Penalties encourage voluntary compliance by defining standards of compliant behavior, defining remedial consequences for noncompliance, and providing monetary sanctions against taxpayers who do not meet the standard. These three factors support the public conviction that the tax system is fair and the penalty is in proportion to the severity of the noncompliance.” “Thus, penalties support the IRS's goals only if they enhance voluntary compliance.” Although penalties support and encourage voluntary compliance, they also serve to "bring additional revenues into the Treasury and indirectly fund enforcement costs. However, these results are not reasons for creating or imposing penalties."

iii. Reliance on erroneous IRS written advice.

1. Under Reg. §301.6404-3, the IRS is statutorily required to abate <u>any</u> portion of <u>any penalty</u> attributable to written erroneous advice it furnishes to a taxpayer.

    a. The portion of any penalty attributable to erroneous IRS written advice can be waived if:

        i. The advice is reasonably relied on by the taxpayer;

        ii. The written IRS advice is issued in response to a written request for advice by the taxpayer; and

        iii. The taxpayer has provided sufficient and correct information in connection with the request.

        iv. A taxpayer will not be seen as having reasonably relied on advice that he receives after first filing a return or taking an action to which he requests advice. Moreover, the taxpayer can no longer claim reasonable reliance after they are put on notice that the IRS's position on the written advice has changed.

    b. Abatement requests related to erroneous IRS advice are accomplished by filing Form 843 "Claim for Refund and Request for Abatement", with the IRS service center where the taxpayer filed the return for which it relates, with the words "Abatement of penalty or addition to tax pursuant to § 6404(f)" written across the top. The Form 843 must include a copy of the written request for advice, and the alleged erroneous written advice received back from the IRS along with any documentation received regarding the penalty, and an indication if the penalty was paid or not. The 843 must be filed within the penalty's collection period or within the refund statute period if the penalty was paid and a refund is requested.

2. IRS erroneous oral advice

    a. Under the IRM, the IRS provides relief for erroneous oral advice where appropriate. In addition to the factors described above required for abating a penalty based on erroneous written advice the IRS will also analyze:

        i. Whether the taxpayer exercised ordinary business care and prudence in relying on the oral advice;

ii. Whether there was a clear cause and effect between the taxpayer's tax scenario, the oral advice provided, and the subsequent penalty assessment;

iii. The taxpayer's prior compliance history and experience and sophistication regarding tax requirements;

iv. Whether the IRS provided conflicting written information through tax forms and publications ect.

v. The availability of supporting documentation on the advice requested and the advice received, the IRS office or personnel involved and method and date by which the advice was provided.

iv. Service in combat zone or contingency operation:

1. IRC Section 7508 allows an extension for specified acts for an individual serving in the Armed Forces or serving in support a support role in an area designated as a "combat zone," or when deployed outside the United States away while participating in an operation designated by the Secretary of Defense as a contingency operation. The affected individual is given until 180 days after the period of combat or contingency operation, or related "qualified hospitalization" to file and pay any tax due. The extension also applies to the qualified taxpayer's spouse.

v. Fire, casualty, natural disaster or other disturbance:

1. A fire, casualty, natural disaster, or other disturbance may be grounds for grounds for penalty abatement for the failure to file or pay tax. The taxpayer must be able to show that he or she exercised ordinary business care and prudence, however, due to a fire, casualty, natural disaster or other disturbance that was beyond their control, they were unable to comply tax law. Factors the IRS and the courts considers include:

    a. Timing;

    b. The effect of the event on the taxpayer's business;

    c. The steps the taxpayer took to comply subsequent to the event; and

    d. How soon the taxpayer became compliant once they were so able.

2. Under § 7508A, the IRS has the authority to allow additional time to meet certain deadlines for taxpayers that are affected by a federally declared disaster or a terroristic or military action and have a history of doing just that via written announcement.

vi. Agencies or instrumentalities of the United States:

1. IRS Policy Statement 2-4 found in IRM 1.2.20.1.2 (11-6-81) states that penalties and interest will not be asserted against "agencies or instrumentalities of the United States." The stated intention behind this policy is that governmental agencies and instrumentalities (1) perform important missions intended to provide for the public health and welfare; (2) are funded by the public they serve; and (3) penalties and interest would divert precious resources.

2. This policy can be effectively argued in support of abatements for any entity closely related to an agency or instrumentality of the U.S. like a hospital or medical center.

vii. Death, Serious Illness, or Unavoidable Absence:

1. The death, serious illness, or unavoidable absence of the taxpayer or a member of the taxpayer's family may constitute reasonable cause for late filing, payment, or deposit. Information the IRS will consider includes:

   a. The relationship of the incapacitated person to the taxpayer;

   b. The date of onset and period of the incapacity;

   c. How the incapacity interfered with the taxpayer's compliance;

   d. Whether other business and obligations were interfered with, and

   e. Whether the taxpayer's tax obligations were dealt with promptly after the incapacity ended. In the case of an affected related entity, the incapacity must relate back to the individual having the sole non delegable authority to take the required actions.

   f. In weighing a taxpayer's illness as a basis for reasonable cause, the courts analyze the severity and duration of the illness. The incapacity must be such that the taxpayer cannot function during the period of the incapacity, and so sudden that he or she could not have planned for its onset. For example, under the above analysis parameters a court waived the failure to file penalty for a taxpayer that suffered sudden paralysis that made him bed ridden and required several blood transfusions.

   g. Because a joint return involves two taxpayers, the above test will be separately applied to each. However, the effect a taxpayer's illness on him or herself and on his or her spouse is taken into account.

e. Grounds that will not ordinarily establish reasonable cause unless they fall in the limited circumstances described below.

i. Tax preparation software errors:

1. The erroneous use of tax preparation software generally will not constitute reasonable cause in order to avoid a penalty. The rational for this is that tax preparation software is only as good as the information the taxpayer inputs into it (Garbage in garbage out). Additionally, the taxpayer is prohibited from shifting their responsibility to file an accurate return to their preparer or software vendor.

ii. Incarceration:

1. Incarceration will not support a finding of reasonable cause for failing to timely file a return.

iii. Fifth amendment concerns:

1. The privilege against self-incrimination extends only to a taxpayer's refusal to answer specific questions in a specific tax return, and will not constitute reasonable cause as to the non-filing of a return even where the decision not the file was based on the advice of counsel.

iv. Records Unavailable:

1. The unavailability of records is ordinarily not considered reasonable cause for a taxpayer's failure to file a return. The taxpayer in this is situation is required to estimate his or her tax liability based on the best information available and possibly to obtain an extension of time to file while the necessary records are obtained.

2. The non-availability of records may constitute reasonable cause in certain limited circumstances. Where a taxpayer can demonstrate that they exercised ordinary business care and prudence, but because of circumstances beyond their control, the taxpayer was none the less unable to comply. The following factors out of IRM 20.1.1.3.2.2.3 (12-11-09) will be considered:

    a. Why the missing records are needed to file;

    b. Why the missing records are unavailable and what actions were taken to obtain the missing records;

    c. When the taxpayer became aware that he or she did not have the necessary records;

    d. Whether alternative means were explored to secure needed information;

    e. Why the taxpayer failed to estimate the missing information;

    f. Whether the taxpayer contacted the IRS for guidance; and

g. Whether the taxpayer promptly complied once the missing information was received.

3. The taxpayer may not be unable to access his records because he or she lost records due to a fire, casualty, natural disaster or other disturbance. In the case of a significant natural disasters affecting numerous taxpayers, the IRS generally provides specific related guidance for penalty relief.

4. In a community property state the inability to obtain information from the other spouse despite reasonable efforts constitutes reasonable cause. The inability to obtain information from a spouse, however, is not reasonable cause to delay the filing of a joint return. Where a joint return is to be filed, both spouses are responsible for filing the return. Each spouse has the option of filing MFS based solely on their own information.

v. Time and Business Pressures:

1. The taxpayer's excessive workload will not constitute reasonable cause for penalty abatement purposes. Taxpayer's are required to exercise ordinary business care and prudence such that they do not take on excessive business commitments to the point of interfering with their tax obligations. A taxpayer's agents are held to the same standard.

vi. Inability to Pay:

1. The mere inability of the taxpayer to pay the tax that they owe as it become due does not generally provide a basis for penalty abatement. The concept of ordinary business care and prudence requires a taxpayer to provide for his or her taxes as they become due. However, in situations where taxpayer's are unable to pay, be on the lookout for an underlying undue hardship that may provide a basis for obtaining an extension of time to pay any tax that becomes owed. To get such an extension, the taxpayer must be able to show that he or she would face an exasperated hardship if forced to pay their taxes as they become due. Being forced to sell property at its current fair market value will not ordinarily be viewed as an undue hardship.

vii. Ignorance of the Law:

1. Ignorance of the law will not ordinarily provide grounds for penalty abatement. The concept of ordinary business care and prudence prevents a taxpayer's erroneous belief (that does not turn on the advice of their tax professional) that no return is required, a misunderstanding of a return's due date, or an incorrect understanding regarding the taxability of a transaction, because it requires taxpayers to make reasonable efforts to correctly determine their income tax obligations.

2. However under IRM 20.1.1.3.2.2.6(4) (11-25-11), a taxpayer may have reasonable cause for being in noncompliance if the taxpayer was not aware of a filing requirement and he or she could not within reason be expected

to know of it. Therefore, ignorance of the law in combination with factors such as the following could possibly result in penalty abatement:

a. The taxpayer's education (or lack thereof);

b. If the taxpayer was not previously subject to the tax or penalized for similar situations in the past;

c. Where there is a change in tax law or forms which the taxpayer could not have been reasonably expected to have known;

d. The severe complexity of the tax issue

viii. Constitutional objections and religious beliefs:

1. Both a taxpayer’s constitutional objections to the federal income tax regime and his or her religious beliefs have been held by the courts to be invalid reasons for failing to honor ones tax obligations and thus will not support a penalty abatement request.

ix. Mistake or Forgetfulness:

1. A taxpayer's mistake that is not based on the advice of counsel, forgetfulness, or carelessness will not provide grounds for penalty abatement because such actions will not show that they have performed with the requisite level of ordinary business care and prudence.

x. Error or lack of performance by and employee or agent:

1. The neglect, error or lack of performance by a taxpayer's employee or agent will not constitute reasonable cause. The courts have held in essence that tax compliance is a non-delegable duty. So in situations where a taxpayer's employee has failed to timely file returns and pay the associated taxes, courts have held the taxpayer responsible for filing, paying, and depositing taxes and held the taxpayer cannot avoid the ultimate responsibility for these tasks by delegating to an employee or other agent the duty to comply with the law.

f. Relief under the 301.9100 sequence of code sections:

i. Requests for relief subject to this sequence of code sections will only be granted when the taxpayer provides evidence and affidavits to establish that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the Government. See late election relief via a PLR above for what is required.

9. Time and manner in which to claim the reasonable cause exception:

a. The taxpayer or his representative may formally request the non-assertion in advance of the penalty being assessed or the subsequent abatement of an assessed penalty;

i. During or after an examination before a penalty is officially assessed.

ii. With a return that is either filed or paid late and a penalty is expected to be assessed.

iii. After notification that a penalty has been assessed.

10. Penalty or late election relief via an administrative waiver via the IRS revenue procedures:

a. Rev. Proc 2013-30:

i. Rev. Proc. 2013-30 governs the late election relief that is granted to certain late election filing entity taxpayers. This Revenue Procedure combines numerous other Revenue Procedures and provides relief guidance for various late elections, including those for: (a) S corporation status; (b) electing small business trust (ESBT) status; (c) qualified Subchapter S Trust (QSST) status; (d) qualified subchapter S subsidiary (QSub) status; and (e) for certain corporate classification elections.

ii. Procedural Requirements under Rev. Proc. 2013-30:

1. Certain notable procedural requirements must also be complied with under Rev. Proc. 2013-30, namely:

a. The relevant delinquent election form must state at the top that it is being "Filed Pursuant to Rev. Proc. 2013-30."

b. Attach the delinquent election form to the current Form 1120S. Please note: An extension granted to file Form 1120S does not allow the s election form to be filed beyond the general rule of 3 years 75 days.

c. On the top of Form 1120S it must state "Includes late election(s) filed pursuant to Rev. Proc. 2013-30."

d. All supporting statements must be signed under the penalty of perjury.

iii. Late S Election:

1. Where a timely S election is missed, Rev. Proc 2013-30 allows the election to be made within 3 years and 75 days of the effective date of the election, provided that (i) it would have qualified for the election in the first place; (ii) there was reasonable cause for failing to make the election; (iii) the sole reason for not obtaining S corporation status is due to a failure to timely file for the election; (iv) and all of the shareholder's tax returns reported income consistently (as though the election were made)—meaning, the entity flowed through its income on K-1's to the shareholders and the shareholders reported the K-1 income.

2. The effective date of Rev. Proc. 2013-30 is September 3, 2013.

iv. Exception 3 Year/75 Day Rule:

1. As an exception to the above rule, a S election may be made beyond the 3 year plus 75 day window, if the entity is a corporation (rather than a limited liability company seeking an entity classification) that meets the following criteria: (i) the corporation failed to be an S corp only because it failed to timely elect to be taxed as an S corp; (ii) the entity and shareholders reported as though the election were in effect; (iii) 6 months or more has passed since the date the corporation filed its return for the year it intended to make an S election (and the IRS did not notify the corporation or any shareholder of an S election problem within that 6 months after Form 1120S was timely filed); and (iv) the completed election form contains the required statements (as further described in Rev. Proc. 2013-30).

b. Rev. Proc. 2014-1:

i. For entities that do not qualify for relief under Rev. Proc 2013-30, they may qualify under Rev. Proc. 2014-1 by requesting a PLR. This Revenue Procedure outlines the criteria and related fees for requesting a ruling.

c. Rev. Proc. 2003-43: Provides for ESBT and QSST late elections relief if within 24 months of the due date of the required election.

i. Rev. Proc. 2003-43 provides guidance for taxpayers seeking relief for a late Electing Small Business Trust (ESBT) or Qualified Subchapter S Trust (QSST) election. The request for relief must be made within two (2) years (24 months) from when the election should have been made.

ii. Alternative relief is provided by Rev. Proc. 2004-49 for QSub elections that are terminated as a result of certain transfers. Specifically, if a QSub election is terminated a result of a sale (or reorganization under Section 368(a)(1)(A), (C), or (D), but not (F)) of all of the QSub stock to an acquiring S corporation. After the transfer, the acquiring corporation may obtain prospective relief for the current year by filing Form 8869 with its timely filed return.

d. Entity classification relief under Rev. Proc. 2009-41:

i. An entity may be eligible for late election relief under Rev. Proc. 2009-41 if:

1. the entity failed to obtain its desired classification solely because Form 8832 was not filed timely;

2. and either

a. the due date of the federal tax return for the entity's desired classification for the tax year has not passed for the first year in which the election was intended

b. or the entity and each related individual, timely filed federal tax returns in accordance with the entities requested classification for all of the years the requested election is to be effective for.

i. An entity and an related individual are treated as timely filing a required return if the return is filed within 6 months after its due date, excluding extensions;

3. the entity has reasonable cause for its failure to make a timely election and

4. 3 years and 75 days from the requested effective date have not passed.

5. Even where an entity cannot meet the eligibility criteria of Rev. Proc. 2009-41, the Service may nonetheless at its discretion grant section 9100 relief in appropriate circumstances (See Reg. § 301.9100).

11. Late election relief via a Private Letter Ruling:

a. Basics on PLR's:

i. A Private Letter Ruling (PLR) in essence is a method to obtain a reliable determination on how the IRS will treat a transaction or set of transactions for federal tax purposes. A PLR is written by IRS Chief Counsel's Office and interprets and applies the federal tax laws to a client's specific set of facts. For the most part, all IRS personnel will honor a letter ruling, but only as to the taxpayer to whom the ruling was issued and only for set of transactions inquired about in the ruling. Procedural guidance on how to go about requesting a PLR is provided in an annually updated revenue procedure that is normally the first published revenue procedure each tax year (See Rev. Proc. 2014-1).

ii. If a transaction is already finalized or cannot be changed, the taxpayer or his or her CPA may not want to call attention to the transaction. Be aware that if a tax practitioner submits a PLR request and subsequently withdraws it, Chief Counsel's office may notify the appropriate IRS officials that have examination jurisdiction over the affected tax returns of the withdrawal along with its views on the proposed transaction(s). Generally where the practitioner finds prior favorable rulings on a proposed transaction set it is a good indication that the ruling obtained will also be favorable but this cannot be guaranteed to the client. The taxpayer is prohibited from simply claiming that he or she falls under another taxpayer's PLR ruling and argue that they are entitled to the identical tax treatment.

iii. The process of obtaining a PLR often takes two to three months and can take longer in the months where returns are being processed.

b. Late election relief via a PLR:

i. The IRS may grant at its discretion requests for late election relief or extensions of time to file elections beyond any applicable time period allowed for in the tax code via a PLR request where the taxpayer is able to provides evidence to show that they acted reasonably and in good faith and that granting relief will not prejudice the interests of the government (See IRC § 301.9100-3). The request will have to be supported with appropriate taxpayer affidavits made under penalties of perjury to be possible.

ii. A taxpayer who receives an extension or late election relief is deemed to waive any future objections to a subsequent examination of the issues raised in the relief request and to any related adjustments.

iii. Reasonable action and good faith surrounding late elections:

1. In general, a taxpayer is deemed to have acted reasonably and in good faith if:

    a. the taxpayer requests PLR relief before the IRS discovers that the taxpayer failed to timely make a required regulatory election;

    b. the failure to timely make the election was caused by intervening events that were beyond the taxpayer's control;

    c. the election was missed after the taxpayer exercised reasonable diligence (taking into consideration the taxpayer's experience, sophistication and the level of complexity of the issues involved), the taxpayer was unaware the election was required or needed; or

    d. the taxpayer reasonably relied on the written advice of the IRS or the written or verbal advice of a qualified tax professional, or employee with the requisite tax expertise, and the professional failed to advise the taxpayer to make the election.

2. Lack of Good Faith:

    a. A taxpayer is deemed to have not acted in good faith if the taxpayer:

        i. seeks to change a filing position that an accuracy-related penalty has or could be imposed at the time the taxpayer requests PLR relief taking into consideration the actual or intended filing of an amended return and the revised filing position requires an election that is the subject of the PLR relief request.

        ii. was fully informed of the election and its tax consequences and chose not to file the election; or

        iii. used the benefit of hindsight in requesting PLR relief.

            1. If the facts have evolved, during the time period since the original election was required to be filed and the making of the PLR request, in a manner that the makes the election advantageous to the taxpayer, the IRS will grant relief only where the taxpayer is able to provide proof that the decision to seek PLR relief did not involve hindsight.

3. Reasonable reliance on a qualified tax professional:

    a. A taxpayer will not be considered to have reasonably relied on a qualified tax professional where the taxpayer knew or should have known that the professional was not sufficiently competent to render the proper advice on the regulatory election or the professional was not made aware of all the relevant facts.

iv. Prejudice to the government's interest:

1. Under Regs. § 301.9100-3(c), the government's interest is prejudiced if granting the requested PLR relief results in a taxpayer having a lower tax liability in the aggregate than if the PLR were not granted.

v. Effect of subsequent withdrawal of PLR request:

1. A taxpayer's subsequent withdrawal of his or her request for a private letter ruling request upon coming to the understanding that it is likely to be adverse has been shown in case law to be a factor that suggests that the taxpayer did not exercise good faith for penalty abatement / late election relief analysis purposes.

c. Lack of relief available for late marked to market elections:

i. Requests for extensions of time to make § 475(f) elections are unlikely to be successful although Regs. § 301.9100-1(c) provides that the Commissioner discretion to grant a reasonable extension of time to make a regulatory election or statutory election.

12. 1362(f) relief for inadvertent termination of S Corporation elections via Private Letter Ruling:

a. The IRS has historically granted relief at its discretion under section 1362(f) for inadvertent terminations of S corporation elections via PLR request. The PLR relief request procedure is delineated in Revenue Procedure 2007-62. The 1996 Small Business Act, gave the IRS the authority to waive the effect of an invalid S election caused by an inadvertent failure to qualify as an S corporation or to obtain the required shareholder consents.

b. The IRS has granted waivers for inadvertent terminations caused by the following:

i. Acquisition of stock by ineligible shareholders:

1. (Missed QSST election by a trust beneficiary, non-permitted trusts, partnership, corporation, non-resident alien, pension trust, nonprofit education institution, bank, IRA, charitable corporation)

ii. The creation of a second class of stock:

1. (The use of an anti-dilution clause, non-identical rights between voting and nonvoting stock, preferred and non-preferred stock)

iii. Disproportionate distributions

iv. Ownership of an non-qualified subsidiary

13. Denied penalty abatement request appeal procedures:

a. If the taxpayer's penalty abatement request does not establish reasonable cause to the service’s satisfaction, the IRS may request additional information and then reevaluate the request or reject the request outright. If the request is rejected, the IRS will provide written notification to the taxpayer of the rejection and of the taxpayer's appeal rights. The notice of denial ordinarily provides an explanation for the denial and instructions on how to submit a written protest.

b. In litigation surrounding a civil penalty of an individual, the IRS bears the initial burden of proof before a court can legally impose it. Whether a reasonable cause has been established, willful neglect or good faith occurred are questions of fact. A determination of what elements must be present to abate a penalty is a question of law. The taxpayer however bears the heavy burden of producing evidence to support any abatement argument.

c. Appeals of penalties that are subject to the deficiency procedures

d. The deficiency procedures are required before additional income tax can be assessed and will also apply to penalties that are calculated on an additional income tax assessment. By way of example the deficiency procedures are required to assess an accuracy-related and fraud penalties because these penalties are based on 20% / 75%, respectively, of an additional income tax assessment. However with failure to file / pay penalties this may not be the case if based on a taxpayer filed return (self-assessment).

e. It is not entirely clear under the code why certain penalties are subject to the deficiency procedures and others are not. This matter does not turn based on the amount of the penalty. While it is true that many of the penalties that are excluded from the deficiency procedures are in practice comparatively of lesser financial consequence this is not the rule. Some failure to file returns penalties are subject to the deficiency procedures while others are not. The point is to determine if the deficiency procedures can be used to challenge the assessment of penalties or if another method is required to challenge them.

f. Forms of protest:

i. Penalty appeals generally come in four flavors;

1. Reasonable cause;
2. Statutory exceptions;
3. Administrative waivers; or
4. Correction of IRS error

ii. Appeals will take into consideration the hazards of litigation and the four methodologies above in choosing to mitigate penalties and interest. However, appeals will only consider abating a penalty where a request for penalty abatement was previously denied by the IRS and the taxpayer requests review of the penalty abatement denial at a subsequent appeal.

iii. Appeals can make an independent determination if the taxpayer performed or failed to perform in manner that would generate a penalty. This basic liability should be examined before a determination if reasonable cause or other methods of obtaining relief are sufficient to abate a penalty. Appeals additionally has the authority to settle penalties for less than the attempted assessment based on the hazards of litigation they perceive.

14. Missed 90 day letter:

a. A CPA should avoid at all cost being held to be responsible for a client failing to file a tax court petition within the prescribed 90 day period. This can been grounds for a malpractice claim where a taxpayer loses their appeal rights.

b. An IRS notice of deficiency, commonly referred to as the statutory notice or "90 day letter", because a taxpayer has 90 days to respond to it or the deficiency becomes legally enforceable, is the taxpayer's "ticket to Tax Court" because without it the Tax Court will not hear the case because it lacks jurisdiction. The IRS is required to include in the deficiency notice the last day on which the taxpayer can file a petition in the Tax Court.

c. The petition for redetermination of a deficiency must be filed with the Tax Court within 90 days of the date the notice of deficiency is mailed to the taxpayer. If the deficiency notice is mailed to a taxpayer who is outside of the United States then the petition must be filed within 150 days of the date the notice is mailed to the taxpayer.

d. The petition should be sent to the Tax Court via United States Postal Service registered or certified mail, return receipt requested, or by another Tax Court approved delivery service. The date of mailing, as evidenced by a United States postmark or acceptable substitute, is treated by the Tax Court as the date of filing. Since timely filing is a jurisdictional requirement, having available proof of timely mailings is paramount in the event the petition is held to be received late, or worse yet, does not arrive at all.

i. Damage control:

1. Filing a collection due process appeal on the grounds of doubt as to liability.

a. Tax professionals occasionally challenge an assessment through the filing a CDP (doubt as to liability). If the challenge is not barred on procedural grounds, it is extremely important to raise <u>all</u> potential arguments against the assessment in the CDP hearing because issues not raised may be barred in any subsequent litigation surrounding the CDP hearing.

i. A taxpayer will be barred from asserting "reasonable cause" for penalty abatement in any subsequent litigation if they did not raise it in the CDP hearing that leads to the litigation.

b. Before the IRS can levy it must give the taxpayer 30 days written notice of his or her right to a collection due-process appeal in order to receive an independent review as to whether the pending collection action is warranted and appropriate in consideration of other available collection alternatives.

c. If the taxpayer (or his tax professional) does not timely request a CDP Hearing they may request an equivalent hearing. An equivalent hearing generally follows the same procedures and considers the same issues as a CDP hearing would however a determination following an equivalent hearing is not subject to judicial appeal and collection action is not required to be suspended during an equivalent hearing (yet another malpractice trap for the CPA).

d. The taxpayer is legally entitled to challenge the underlying tax liability only where the taxpayer did not receive a statutory notice of deficiency or otherwise did not have an opportunity to dispute the assessment. Making an offer-in-compromise based on doubt as to liability is essentially a challenge to the underlying assessment and cannot be argued in a CDP hearing if the taxpayer had a prior opportunity to dispute the assessment.

e. The following events constitute a prior opportunity to dispute the tax liability which will effectively bar a CDP appeal.

    i. The taxpayer received a notice of deficiency but failed to file a Tax Court petition.

    ii. The taxpayer refused delivery of the 90 day letter.

    iii. The notice of deficiency was mailed to the taxpayer's last known address but was not actually received or was received too late to file a timely petition. A taxpayer’s last known address is the address which appears on the taxpayer’s most recent federal tax return, unless the IRS is given clear and concise notification of a different address.

        1. Note: Very dangerous where CPA has a POA and the client is off in Europe for an extended vacation.

2. Consider having the taxpayer pay the deficiency and sue for a refund in federal district court.

3. Consider requesting audit reconsideration.

4. Consider contacting the taxpayer advocates office and request a Taxpayer Assistance Order (TAO).

a. The CPA can attempt to argue a taxpayer is suffering or is about to suffer a significant hardship as a result of the manner in which the tax laws are being administered by the IRS and request a TAO.

15. Non-filers:

    a. Spies Evasion:

        i. When working with non-filers it is common wisdom that non-filers with large balances due that span several years should be referred out to a qualified tax attorney for evaluation for exposure to "Spies Evasion". The referring CPA can be engaged on a Kovel letter to prepare the delinquent returns which would render communications with the CPA subject to attorney client privilege.

        ii. The "Spies evasion" doctrine is, essentially, one of the ways of committing tax evasion. It is a legal theory that finds a taxpayer criminally liable when he willfully (1) fails to file a tax return(s), and (2) his actions are coupled with "affirmative acts of evasion," like actively concealing or misleading the government. In Spies the Supreme Court identified at least seven examples of conduct that constituted affirmative acts of evasion. The Court stated: [We] "think [the] affirmative willful attempt may be inferred from conduct such as [1] keeping a double set of books, [2] making false entries of alterations, [3] or false invoices or documents, [4] destruction of books or records, [5] concealment of assets or covering up sources of income, [6] handling of one's affairs to avoid making the records usual in transactions of the kind, and [7] any conduct, the likely effect of which would be to mislead or to conceal." Spies v. United States, 317 U.S. 492, 499 (1943).

        iii. An "affirmative act" for purposes of the Spies evasion doctrine may be any number of things, including but not limited to, making a false statement to the IRS, either oral or written. Importantly, the statement could be made before, after, or at the same time as filing the tax return. Thus, for example, a taxpayer makes an "affirmative" act of evasion after failing to file his income tax return when he lies to the IRS about how much income he earned.

        iv. What are the Penalties for Spies Tax Evasion?

            1. Spies evasion is a more serious offense than willful non-filing of tax returns. This is because the mere non-filing of a tax return is typically a Section 7203 misdemeanor (which are rarely charged by the IRS) while a Spies evasion offense may cause that offense to rise to the level of a Section 7201 felony.