

Penalties Above 20%: What Are They, When Are They Applied, and How Do You Defend?

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AUSTIN, TEXAS
DECEMBER 13, 2017

The Growth of Penalties

Purpose of penalties

- “Penalties exist to encourage voluntary compliance by supporting the standards of behavior required by the [Code].”
 - Internal Revenue Manual (“IRM”) 20.11.2 (Feb. 22, 2008)
- Not intended as a revenue raiser

More than 150 civil penalties authorized

- More than 10-fold increase from the 13 penalties in 1954 Code

Statistics (FY 2016)

- IRS assessed 29.3 million civil penalties totaling \$27.3 billion
 - Approximately \$12.1 billion assessed against individuals, estates, trusts
- IRS abated 5.2 million civil penalties totaling \$8.9 billion

Developments in the Burden of Production

Burden of Production Updates

IRC. § 6751(b)(1)

- “No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.”
- Not applicable to:
 - Additions to tax under I.R.C. §§ 6651, 6654, or 6655; and
 - Other penalties automatically calculated via electronic means
- TIGTA 2013 Report Re: Preparer Penalties
 - 8% noncompliance rate in preparer context
 - Prevalence in deficiency cases?

Burden of Production Updates

- Deficiency cases:
 - *Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017)
 - “[W]e hold that § 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.”
 - “[W]e further hold that compliance with § 6751(b) is part of the Commissioner’s burden of production and proof in a deficiency case in which a penalty is asserted.”
 - “Read in conjunction with § 7491(c), the written approval requirement of § 6751(b)(1) is appropriately viewed as an element of a penalty claim, and therefore part of the IRS’s *prima facie* penalty case.”
 - *But see Graev v. Commissioner*, 147 T.C. No 16 (2016)
 - “Because respondent has not yet assessed the section 6662 penalties at issue in this [deficiency] case, it is premature to consider whether respondent has satisfied section 6751(b).”
- CDP cases:
 - *Graev v. Commissioner*, 147 T.C. No. 16 (2016)
 - “We do not foreclose the possibility that a taxpayer who believes that a penalty has been assessed in violation of 6751(b)(1) might raise this issue in a postassessment collection due process (CDP) proceeding.”

FOIA and Discovery-Related Requests

Taxpayer Name: [Redacted] Examiner: [Redacted]
 TIN: [Redacted] Date: [Redacted]
 Tax Year (s): [Redacted]

CIVIL PENALTY APPROVAL FORM

Conclusion:
 appropriate
 not appropriate
 Reason(s) for Non-Assertion of Penalty(s): IRM 4.10.6.7(1)
 No Change or Refund Case
 Deficiency Case (Explanation required when adjustments made and penalties are not asserted. The applicable exceptions to the penalty must be documented)

Reason(s) for Assertion of Penalty(s) IRM 4.10.6.7(1)
 This case involves a donation of a Fugate Element which was taken as a Charitable Contribution. The partnership has failed to substantiate the deduction taken. The penalty is being issued in accordance with IRC 6629(b) - Gross Violation Mismatch.

Group Manager Approval to Assess Penalties Identified Above IRM 25.1.5.1.8
 (Not for non-assertion of Substantial Understatements Penalty unless under criteria for penalty tax basis only)

Group Manager Signature: [Redacted] Date: [Redacted]

Taxpayer Name: [Redacted] Examiner: [Redacted]
 TIN: [Redacted] Date: 04/20/2014
 Tax Year (s): [Redacted]

IRC	Penalty	IRM	Assess Penalty	Reference
6601(b)(1)	Failure to file (domestic and non-fiduciary) (Local Street available)	20.1.2.2.7	X	
6651(a)(2)	Failure to Pay	20.1.2.1.8.4 and 20.1.2.2.10	X	
6654	Estimated Tax - Individual	20.1.3.3	X	
6655	Estimated Tax - Corporate	20.1.3.3	X	
IRC	Penalty	IRM	Assess Penalty	Reference
6611(b)	Preparer Penalties - Manager Approval	20.1.2.2.7.1	X	
6612	Preparer Penalties - Understatement Due to Willful or Reckless Conduct (Local Street available)	20.1.5.1	X	
6613	Preparer Penalties - Understatement Due to Negligence or Recklessness (Local Street available)	20.1.5.1	X	
6614	Preparer Penalties - Other Accuracy Related	20.1.5.1.1	X	
6621	Cross Violation Mismatch	20.1.5.1.8.4	X	
6622	Accuracy Related Penalty on Understatements with Respect to Reportable Transactions	20.1.5.1.3	X	
6707A	Failure to Include Reportable Transactions (Inclusion with Return or Statement (see 6707(b)(2) Alternative Transactions and/or) (Local Street available)	20.1.5.1.3 and 4.3.2	X	
6707B	Alternative Penalty Section	20.1.5.1.3	X	
Consideration of Preparer/Practitioner/Advisor Penalties			Assess Penalty	Reference
6604(b)	Preparer Penalties - Understatement Due to Unreasonable Caution (Local Street available)	20.1.6.3.7	X	
6604(c)	Preparer Penalties - Understatement Due to Willful or Reckless Conduct (Local Street available)	20.1.6.3.10	X	
6605(a)	Failure to Furnish Copy to Employer	20.1.6.4.1	X	
6605(b)	Failure to Sign Return/Return for Refund	20.1.6.4.2	X	
6605(c)	Failure to Furnish Identifying Number	20.1.6.4.3	X	
6605(d)	Failure to Retain Copy of List	20.1.6.4.4	X	
6605(e)	Failure to Maintain Record of Preparer's Employer	20.1.6.4.5	X	
6605(f)	Retention of Preparer's Penalty Check	20.1.6.4.6	X	
6605(g)	Failure of Due Diligence with Respect to EIC	20.1.6.4.7	X	
6701	Providing Abusive Tax Strategies	20.1.5.1.3	X	
6702	Allowing a Partner to Incur a Liability	20.1.5.1.3	X	
6707	Failure to Furnish Information Regarding Reportable Transactions	20.1.5.1.3	X	
6708	Failure to Maintain List of Advisees with Respect to Reportable Transactions	20.1.5.1.6	X	
6713	Unauthorized Disclosure or Use of Information	20.1.8.1	X	

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First appeared as part of the conference materials for the
65th Annual Taxation Conference session

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