

# Penalty Abatement & Reasonable Cause

Presenter: A.J. Reynolds

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## Penalty Abatement & Reasonable Cause



Late Filing  
Penalty



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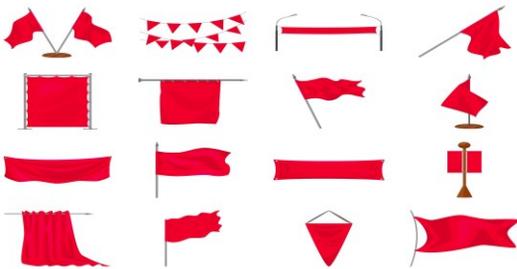
## Quote of the Session



**“Worried about an IRS audit? Avoid what’s called a red flag. That’s something the IRS always looks for. For example, say you have some money left in your bank account after paying taxes.**

**That’s a red flag.”**

*--Jay Leno--*



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## Penalty Abatement & Reasonable Cause



Provide useful techniques to support tax professionals in assisting clients with reducing penalties imposed by various sections of the Internal Revenue Code.

**TAX  
PENALTY!**

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## Penalty Abatement & Reasonable Cause



Description	Form 8821	Form 2848
Access Information	✗	
Speak on behalf of client		✗
Argue client's tax position		✗
Represent client before IRS		✗
Third Party Disclosures		✗

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## Penalty Abatement & Reasonable Cause



- **Agenda:**
  - Glossary of Terms to Know
  - Introduction to Penalties
  - Reasonable Cause Assistant {RCA}
  - First Time Abatement Program {FTA}
  - Reasonable Cause
  - Standards & Authorities

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## Penalty Abatement & Reasonable Cause



- **Agenda:**
  - Abatement and or Appeal Letter Formats
  - Case Law
  - [Revenue Procedure 84-35](#)
  - [Form 843](#)
  - [Forms 8275 & 8275-R](#)

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## Penalty Abatement & Reasonable Cause



- **A good tax professional... is worth their fee.**



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## Penalty Abatement & Reasonable Cause

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- Based on reasonable cause and taxpayer acted in good faith:
  - Easy to comprehend words, however, they are essentially expressions of art!
  - Taxpayer shows reasonable cause and not willful neglect.
  - Taxpayer must exercise ordinary business care and prudence.
  - Facts and circumstances on case-by-case basis.

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## Penalty Abatement & Reasonable Cause

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- **GREAT FACTS = GREAT CASE**
- ✓ • *We must interview the client!*

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## Glossary of Terms

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- Electronic Federal Tax Payment System (EFTPS)
- Failure to File (FTF)
- Failure to Pay (FTP)
- First Time Abate (FTA)
- Reasonable Cause Assistant (RCA)



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## Glossary of Terms

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- **Administrative Waiver**
- ✓ • IRS addresses in policy statement, news release, or other formal communications
- **Reasonable Cause**
- ✓ • “Good Excuse Doctrine”
- **Statutory Exceptions**
- ✓ • Code or Regulations

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## Glossary of Terms

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- **Internal Revenue Service Restructuring and Reform Act of 1998 (RRA98)**
  - ✓ • Required notices to include name of penalty, code section, and computation
  - ✓ • Required specific approval of IRS management to assess penalties on computer generated
- **Internal Revenue Manual**
  - ✓ • IRM = Source of Abundant Material

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## Penalties for FTF and FTP

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- FTF (14%) and FTP (56%) account for 70% of penalties
- FTF = 5.0% per month for maximum of 25%
  - *Why it is always important to file, even if taxpayer cannot pay*
- FTP = 0.5% per month for maximum of 25%
- If both FTF and FTP apply in same month, than FTF = 4.5% and FTP = 0.5%, hence if both apply, max penalties would be at 47.5%
- IRS Assesses approximately 40 million civil penalties each year and only 11% are abated

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## Purpose of Penalties

- Penalties exist to encourage voluntary compliance
- Voluntary compliance is achieved when taxpayer makes a good faith effort to meet their obligations
- Most penalties apply to behavior that **fails to meet certain obligations**



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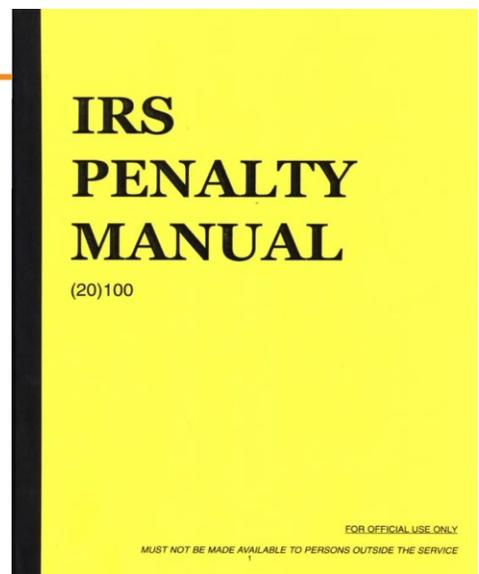
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## Penalty Administration

- [IRM 20.1.1.2.2 \(11-25-2011\)](#)
- ✓ • Consistency
- ✓ • Accuracy
- ✓ • Impartiality
- ✓ • Representation

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## Introduction to Penalties



- There were approximately 14 penalty provisions contained in the 1954 Internal Revenue Code.
- More than 150 penalties exist in the Internal Revenue Code today.

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## Introduction to Penalties



- **Think accuracy related**
  - ✓ • Careless / Reckless / Intentional Disregard
- **Negligence**
  - ✓ • Not defined by IRS
  - ✓ • Failure to make reasonable attempt to comply

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## Polling Question #1



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## Reasonable Cause Assistant {RCA}



- [IRM 20.1.1.3.6 \(10-19-2020\)](#)
- Artificial Interactive Intelligence Software Program
- Decision-Support
- Consistent and equitable administration



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## First Time Abatement {FTA}



- [IRM 20.1.1.3.3.2.1 \(10-19-2020\)](#)
- Began in 2001
- [Administrative Waiver \(20.1.1.3.3.2\)\(08/05/2014\)](#)
- Not in the IRC
- Applies only to single tax period

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## First Time Abatement {FTA}



- 3-Year Filing Compliance
- 3-Year Payment Compliance
- 3-Year Clean Penalty History
- ✓ • ES Penalty does not count against
- Available for;
- ✓ • [Failure to File \(FTF\)](#)
- ✓ • [Failure to Pay \(FTP\)](#)
- ✓ • [Failure to Deposit \(FTD\)](#)
- [Cannot use for Accuracy Related Penalty](#)



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## First Time Abatement {FTA}



- Rewards past compliance & promote future compliance
- Only single period, which would be earliest tax period
- Not well publicized by IRS
- 2 million taxpayers would have qualified, however, only 8% requested

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## First Time Abatement {FTA}



- IRS to automate First-time Abatement (FTA) Program



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## Criteria for Relief from Penalties

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- IRM 20.1.1.3 (10-19-2020)
  - 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
    - D. Reasonable cause

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## Substantial Authority

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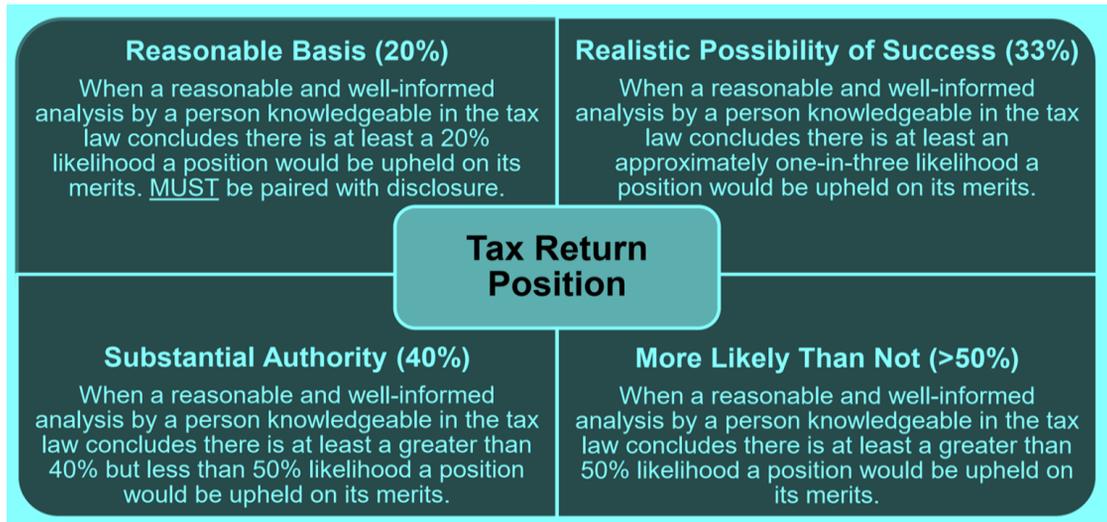


- Substantial Authority in Support of a Tax Position.
- Evaluation of Authorities.
- Due Diligence.

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## Substantial Authority

- [§10.34](#) – Standards with Respect to Tax Returns



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## Substantial Authority

- Does Substantial Authority Exist
- **Objective standard**
- ✓ • Analysis of law & application of law to relevant facts
- ✓ • It all changed in 2008 when the more-likely-than-not standard was switched to “Substantial Authority”

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## Substantial Authority

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- **Objective standard**
- ✓ • Weight of the authorities supporting the treatment is substantial in relation of the weight of authorities supporting **contrary** treatment.

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## Substantial Authority

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- **Order of Authority**
  - IRS FAQ's are NOT Law, **however**.....
    - IRS guidance on FAQs in October 2021

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## Substantial Authority

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- Summary judgment of case suggests that taxpayers must identify and consult tax authorities **EXISTING** at the time returns are filed to support positions.
- [Wells Fargo & Company, 119AFTR 2d 2017-1976 \(DC MN 2017\)](#)

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## Authority

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- [IRM 20.1.1.1.2 \(10-19-2020\)](#)
  - Primary source of authority
  - Provides guidance
  - Sets forth general policy & procedural requirements

AUTHORITY



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## Criteria for Relief from Penalties

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- [IRM 20.1.1.3 \(10-19-2020\)](#)
- Four separate categories
  1. Correction of IRS error.
  2. Statutory & Regulatory exception.
  3. Administrative waivers.
  4. Reasonable cause.

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## Reasonable Cause

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- [IRM 20.1.1.3.2 \(11-21-2017\)](#)
- Exercise ordinary business care and prudence
- ✓ • [Unforeseen circumstances prevented compliance](#)
- ✓ • [Not a conscious, intentional failure or reckless indifference](#)
  - [Willful Negligence](#)

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## Reasonable Cause

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- Leading misunderstood aspect of defending a position is **Reasonable Cause and taxpayer acted in Good Faith.**
- **Easy-to-understand language, however, Reasonable Cause and acted in Good Faith is a language of Art and one in which most taxpayers do not speak nor understand!**

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## Reasonable Cause

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- **Reasonable Cause & Willful Neglect**
- ✓ • Both of these items are determined by taxpayer actions
- ✓ • Were the actions flagrant, willful, reckless, and due to gross negligence

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## Reasonable Cause



- Whether the elements that constitute reasonable cause, willful neglect, or good faith are present is based on ALL the facts and circumstances.



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## Reasonable Cause



- **Reasonable Care**
  - *Standard of care that a reasonably prudent person would use under the circumstances in the course of its business in determining its filing obligations and in handling the documents*



Reasonable Care

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## Reasonable Cause



- **Ordinary Business Care & Prudence**
  - [IRM 20.1.1.3.2.2 \(02-22-2008\)](#)



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## Reasonable Cause



- **Ordinary Business Care & Prudence**
  - ✓ • “Good Faith” on behalf of taxpayers
  - ✓ • [Simonsen \(2018\)](#)
    - Should not penalize taxpayer for mistakes on law in a complicated subject area that lacks clear guidance
  - ✓ • Contemplate taxpayers reasoning, compliance history, length of time, were circumstances beyond taxpayers' control

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## Reasonable Cause



- **Death, Serious Illness, or Unavoidable Absence**

- [IRM 20.1.1.3.2.2.1 \(11-25-2011\)](#)
- ✓ • Taxpayer or immediate family only
- ✓ • Issue must be addressed in a reasonable time
- ✓ • Proof of Illness
- ✓ • Covid Issues



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## Reasonable Cause



- **Fire, Casualty, Natural Disaster, or Other Disturbance**

- [IRM 20.1.1.3.2.2.2 \(10-19-2020\)](#)
- [IRM 20.1.1.3.3.5 \(10-19-2020\)](#)
- ✓ • Financial
- ✓ • Medical
- ✓ • Major Disaster
- ✓ • Covid Issues



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## Reasonable Cause



- **Unable to Obtain Records**

- [IRM 20.1.1.3.2.2.3 \(12-11-2009\)](#)
- ✓ • Was ordinary business care and prudence exercised
- ✓ • Why were records unavailable and what steps were taken to correct
  - Previous accountant went out of business **suddenly**

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## Reasonable Cause



- **Mistake was Made**

- [IRM 20.1.1.3.2.2.4 \(12-11-2009\)](#)
- ✓ • Generally, not in keeping with ordinary business care and prudence
- ✓ • Mistake may be a supporting fact with other additional facts

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## Reasonable Cause

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- **Erroneous Advice or Reliance**
  - [IRM 20.1.1.3.2.2.5 \(11-21-2017\)](#)
  - ✓ • Responsibility cannot be delegated
  - ✓ • Use with other issues
    - Unable to obtain records
    - Ignorance of Law
    - All facts and circumstances need to be addressed

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## Reasonable Cause

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- **Ignorance of the Law**
  - [IRM 20.1.1.3.2.2.6 \(11-25-2011\)](#)
  - ✓ • Education Level
  - ✓ • Penalized previously
  - ✓ • Recent Law Changes
  - ✓ • Level of Complexity

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## Reasonable Cause

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- **Forgetfulness**
  - IRM 20.1.1.3.2.2.7 (08-05-2014)
  - ✓ • Generally, does not keep with ordinary business care and prudence
  - ✓ • Medical Conditions
  - ✓ • All facts and circumstances need to be addressed

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## Reasonable Cause

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- **Undue Hardship**
  - [IRM 20.1.1.3.3.3 \(08-05-2014\)](#)

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## Reasonable Cause

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- **Advice**
  - [IRM 20.1.1.3.3.4 \(08-05-2014\)](#)
  - ✓ • Information to consider
    - Was advice in response to a specific request and was the advice received related to the facts contained in that request
    - Did taxpayer reasonable rely on the advice

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## Reasonable Cause

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- **Written Advice form the IRS**
  - [IRM 20.1.1.3.3.4.1 \(11-25-2011\)](#)
- **Oral Advice form the IRS**
  - [IRM 20.1.1.3.3.4.2 \(12-11-2009\)](#)
  - Ensure you document phone calls or in person meetings with IRS
  - Obtain Badge Number, IRS Employee Name, Date and time telephone call or meeting took place
  - Did taxpayer provide IRS with accurate information
  - Did taxpayer reasonably rely on such advice

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## Reasonable Cause

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- **Advice from a Tax Advisor**
  - [IRM 20.1.1.3.3.4.3 \(11-21-2017\)](#)

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## Reasonable Cause

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- **Advice from a Tax Advisor**
  - **Three (3) Prong Test** (courts have established)
    1. **Adviser was Competent**
    2. **Taxpayer Provided Necessary & Accurate Information to Adviser**
    3. **Taxpayer Actually Relied in Good Faith On Advisers Judgement**

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## Reasonable Cause

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- **Subsequent Requests for Penalty Relief**
  - [IRM 20.1.1.3.5.1 \(10-19-2020\)](#)
    - May be received after initial denied
    - Taxpayer submitting new information
    - Facts presented in new information meet Penalty Relief Criteria

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## Reasonable Cause & Good Faith

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- [Treasury Regulations 1.6664-4](#)
  - The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances.
    - **Review paragraphs (b) through (h) of this section**

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## Reasonable Cause

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- **IRS Guidance to employees in evaluating reasonable cause request:**
  - ✓ • Taxpayer bears burden of proof
  - ✓ • Each case must be evaluated on its own merit
  - ✓ • Did taxpayer exercise ordinary business care and prudence
  - ✓ • Circumstances beyond taxpayer's control and taxpayer unable to meet tax requirement
  - ✓ • Are taxpayer's reasonable cause in-line with penalty imposed

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## Reasonable Cause

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- **IRS Guidance to employees in evaluating reasonable cause request:**
  - ✓ • Taxpayer's compliance history
  - ✓ • Length of time between event cited as a reasonable cause for noncompliance and subsequent compliance by taxpayer
  - ✓ • Consider whether or not taxpayer could have anticipated the event that caused noncompliance

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## Polling Question #2

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## Accuracy-Related Penalty

- 20% portion of underpayment of tax attributable to negligence and substantial understatement
  - **Negligence** means any failure to make a reasonable attempt to comply with the provisions to Internal Revenue Code
  - **Substantial** is the understatement exceeds the greater of \$5,000 or 10% of the correct tax.



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## Accuracy-Related Penalty

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- **Criteria for abatement**
- ✓ • Reasonable Cause
- ✓ • Substantial Authority
- ✓ • Adequate disclosure

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## Accuracy-Related Penalty

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- **Authorities**
- ✓ • [IRC § 6662](#)
- ✓ • [IRC § 6662A](#)
- ✓ • [Regs 1.6662-1 through 1.6662-7](#)
- ✓ • [Regs 1.6664-4](#)
- ✓ • [IRM 20.1.1.3.2](#)

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## Standards & Authorities



IRC Section	Reason
<a href="#"><u>§ 6651(a)(1)</u></a>	Failure to File
<a href="#"><u>§ 6651(a)(2)</u></a>	Failure to Pay
<a href="#"><u>§ 6721</u></a>	Failure to File Correct Information Reporting Returns
<a href="#"><u>§ 6722</u></a>	Failure to File Furnish Correct Payee Statements
<a href="#"><u>§ 6723</u></a>	Failure to comply with Other Information Reporting

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## Standards & Authorities



Description	Resource
Accuracy-Related Penalties	<a href="#"><u>Treas. Reg. §1.6664-4</u></a>
Failure to File a Tax Return and/or Failure to Pay tax Penalties	<a href="#"><u>Treas. Reg. §301.6651-1(c)</u></a>
Failure to Deposit Penalty	<a href="#"><u>Treas. Reg. §301.6656-1(b); Treasury Decision 8947</u></a>
Information Returns Penalties	<a href="#"><u>Treas. Reg. §301.6723-1(A)(d) &amp; Treas. Reg. §301-6724-1</u></a>
Prepare/Promoter Penalties	<a href="#"><u>Treas. Reg. §1.6694-2(e)(1)-(6) &amp; Treas. Reg. §301.6707-1T Q&amp;A (4)</u></a>

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## Reasonable Cause & Good Faith

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- **Resources:**
- [IRC 6662](#) -Imposition of Accuracy-related Penalty on Underpayments
  - *Senior Tax Court Judge Mark V. Holmes has stated:*
    - “Accuracy Related Penalty is Not a Consequence for Being Bad”

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## Reasonable Cause & Good Faith

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- **Resources:**
- [Treasury Regulations §301.6651-1](#)
  - Showing of Reasonable Cause in FTF and FTP situations



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## Reasonable Cause & Good Faith

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- **Resources:**
- [Treas. Reg. 301.6724-1](#) – Reasonable Cause
- [IRC 6724](#) – Waiver; Definitions and Special Rules
- [IRM 20.1.1](#) – Introduction and Penalty Relief
- [IRM 20.1.5](#) – Return Related Penalties

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## Reasonable Cause & Good Faith

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- [IRM 20.1.2.2.4.1 \(07-18-2016\)](#)
- Even though a late filing and paying taxpayer must generally show reasonable cause to avoid these failure penalties, in the absence of reasonable cause, the IRS may still allow a compromise of the penalties if the delinquency was **not flagrant, willful, or due to gross negligence.**

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## Standards & Authorities

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- [Regulations §301.6651-1\(c\)](#) – **Failure to Pay**
- **Example:**
  - “taxpayer who incurs lavish or extravagant living expenses in an amount such that the remainder of his assets and anticipated income will be insufficient to pay his tax, has not exercised ordinary business care and prudence in providing for the payment of their tax liability”.

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## Reasonable Cause – Facts to Determine

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- A. What happened and when did it happen?
- B. What facts & circumstances prevented you from filing your return or paying your tax during the period of time you did not file and/or pay your taxes timely?
- C. How did the facts & circumstances affect your ability to file and/or pay your taxes or perform your other day-to-day responsibilities?
- D. Once the facts & circumstances changed, what actions did you take to file and/or pay your taxes?

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## Reasonable Cause – Facts to Determine

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- **All relevant factors need to be analyzed**
  - ✓ • Complexity of issue
  - ✓ • Competence and reliance of tax advisor
  - ✓ • Taxpayer’s education
  - ✓ • Taxpayer’s experience
  - ✓ • Taxpayer’s knowledge

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## Abatement or Appeal Letter Format

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- Ask client the questions provided on slides titled “Reasonable Cause – Facts to Determine” to formulate your reply to the IRS.
- After interviewing client, apply their answers to the list of reasonable causes set out on previous slides.

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## Abatement or Appeal Letter Format

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- Suggestion when writing abatement letters for appeals, CDP Hearings, IRS Notices, or other abatement requests:
  - ✓ • Statement of Representation
  - ✓ • Statement of Facts
  - ✓ • IRS Position Analysis

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## Abatement or Appeal Letter Format

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- Suggestion when writing abatement letters for appeals, CDP Hearings, IRS Notices, or other abatement requests:
  - ✓ • Taxpayers Position Analysis
  - ✓ • Statement of Law to Support Reasonable Cause
  - ✓ • Conclusion

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## Abatement or Appeal Letter Format

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- **STATEMENT OF REPRESENTATION REGARDING THE PREPARATION OF PROTEST**
  - *The foregoing protest was prepared by the undersigned, A.I. Reynolds, EA, at the request of Joe Sample and from documents, information, and verbal communication provided to this office by Joe Sample. The statement of facts presented in this protest and accompanying documents have been examined by the undersigned, who has no personal knowledge of whether the statements of facts contained herein are true and correct, but upon information and belief, believes them to be true and correct and complete.*

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## Abatement or Appeal Letter Format

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- **First sentence in a written appeal protest must state the following:**
  - **I am requesting a Formal Appeal of Your Decision**
- If this language is **NOT** included in the first line of the written protest, the case will most likely be closed as a “no consideration” and the IRS will take no further action

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## Case Law

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- **Supreme Court** – [United States v. Boyle, 469 U.S. 241 \(1985\)](#)
- ✓ • “The failure to make a timely filing of a tax return is not excused by the taxpayer’s reliance on an agent, and such reliance is **not** “reasonable cause” for a late filing under §6651(a)(1).”

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## Case Law

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- **Supreme Court** – [United States v. Boyle, 469 U.S. 241 \(1985\)](#)
- ✓ • “That the attorney, as respondent’s agent, was expected to attend to the matter **does not** relieve the principal of his duty to meet the deadline.”

case law

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## Case Law



- [Intress v. United States](#), Dkt. No. 3:18-cv-00851 (M.D. Tenn. 2019) 404 F.Supp.3d 1174(M.D. Tenn. 2019) (Published August 2, 2019)
- ✓ • “taxpayers are not obligated to use tax preparation services. Even if certain classes of tax return preparers are now required to use e-file software, it is just as true today as it was in 1985 that a person...can prepare returns personally ... and an individual filing his own return is not required to use e-file software...[t]he decision to use [a return preparer required to use e-file software] is within the taxpayer’s control.”

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## Case Law



- [Wayne Lee vs. US of America](#), 11th Circuit, No. 22-10793 (October 24, 2023)
- ✓ • Dr. Wayne Lee seemed to do everything correct
- ✓ • Paid estimates, which overpaid his tax liability
- ✓ • Overpayment applied to next tax year
- ✓ • Hired CPA and signed Forms 8879 2014, 2015, 2016, 2017
- ✓ • **What happened.....**

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## Case Law

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- [Elstein v. Commissioner](#), T.C. Summary 2022-14
- ✓ • **Liable for penalties**
  - Partner in Law Firm file taxes late
  - Place on involuntary inactive status after illness in 2019
  - Court, expressed sympathy for lawyer's illness
  - Taxpayer failed to introduce any evidence showing how his illness in 2019 could be reasonable cause for late filing taxpayers 2011, 2012, and 2013 tax returns

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## Case Law

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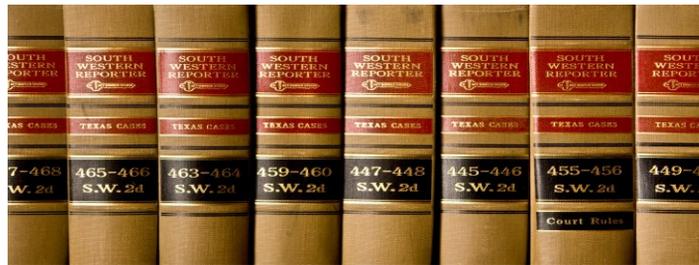
- [Tracy, TC Summ. Op. 2023-30](#)
- ✓ • **Reasonable cause exception**
  - Lawyers' assistant did not pay taxes
  - 87 years old and declining health
  - Taxpayer filed and paid taxes upon learning
  - Requested abatement of penalties
  - Taxpayer not liable
    - His inability to adequately supervise his assistant
  - Taxpayer **exercised ordinary care and prudence** and **not willful neglect**

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## Case Law



- [Corbin & Dorice McNeill V. Comm.](#), Wyoming DC, 14-CV-172-F, Feb 24, 2017
  - **Relief provided from accuracy-related penalty on Sham Transaction**



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## [Revenue Procedure 84-35](#), 194-1 C.B. 509



- **Penalty** under [IRC § 6698](#) for Late Filing of Partnership Tax Return Relief.
  - Taxpayer is a domestic partnership
  - Partnership consists of ten (10) or fewer partners
  - All partners are natural persons

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## Revenue Procedure 84-35, 194-1 C.B. 509

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- **Penalty** under [IRC § 6698](#) for Late Filing of Partnership Tax Return Relief.
  - Each partner's share of each partnership item is the same as his share of every other item and
  - All partners fully reported their respective share income on their individual returns by the due date of the returns.

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## Revenue Procedure 84-35, 194-1 C.B. 509

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- **Program Manager Technical Advice 2020-01 dated November 19, 2019**
  - Applicability of Revenue Procedure 84-35 to Partnerships with Taxable Years beginning on or after January 1, 2018.
    - **Revenue Procedure 84-35 is not obsolete and continues to apply.**

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## Revenue Procedure 84-35, 194-1 C.B. 509

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- **Penalty** under [IRC § 6698](#) for Late Filing of Partnership Tax Return Relief.
- ✓ • **Additional Requirement**
  - “The partnership did not elect to be subject to the rules for consolidated audit proceedings under §§ 6221 through 6234.”

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## Form 843

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- A refund or abatement of interest, penalties, or addition to tax, caused by certain IRS errors or delays, or certain erroneous written advice from the IRS
- A refund or abatement of a penalty or addition to tax due to reasonable cause or to other reason allowed under the law
- Not for refunds on taxes for which a different form must be used, such as Form 1040X, 941X, etc.

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## Forms 8275 & 8275-R

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- Used by taxpayers and tax return preparers to disclose items or positions ([Form 8275](#)), and those taken contrary to a regulation ([Form 8275-R](#)), that are not adequately disclosed on a tax return to avoid certain penalties.
- Valuable protective tool.

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## Forms 8275 & 8275-R

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- IRS knows tax laws are complicated. If you believe you are comfortable with a position, but not positive, disclose it to IRS by using 8275 or 8275-R.
- Do not be frivolous and ensure you have proper records, research and documentation to substantiate your position.
- IRS has stated that by filing form it will not increase your risk of audit.

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## Polling Question #3



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## Questions?



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## Upcoming Webinars:

- Ethics: Part 1 – Maitre – December 18<sup>th</sup> – 1-2pm ET
- Ethics: Part 2 – Maitre – December 18<sup>th</sup> – 2:30pm – 3:30pm ET

December Monthly Newsletter: [CPEhours.com/About/Blog](http://CPEhours.com/About/Blog)

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