

# Be Patient on Reportable Transaction Penalties, Attorneys Say

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By Kristen A. Parillo

Taxpayers who are still in penalty exams should take a strategic approach on how to move forward while the courts are evaluating the validity of the reportable transaction regime.

Paying the penalty and then filing a protective refund claim is an ideal option, but going to IRS Appeals should still be considered by taxpayers who can't afford to pay, panelists said February 1 at the American Bar Association Section of Taxation virtual meeting.

The panel was discussing the legal uncertainty regarding IRS penalty assessments amid pending court cases in which taxpayers have challenged the validity of IRS notices, issued without a formal comment period, that designate listed or reportable transactions requiring disclosure by taxpayers and material advisers.

The IRS prevailed in *Mann Construction Inc. v. United States*, [No. 1:20-cv-11307](#) (E.D. Mich. 2021), in which a Michigan district court held that Congress authorized the IRS to proceed without notice and comment when it designated a cash value life insurance trust as a listed transaction in [Notice 2007-83](#), 2007-45 IRB 960.

The taxpayer appealed to the Sixth Circuit, which heard oral arguments in December 2021. The judges appeared to be skeptical of the government's position that Congress excused the IRS from notice and comment rulemaking, the panel said.

In contrast to *Mann Construction*, the Tennessee district court in *CIC Services LLC v. IRS*, [No. 3:17-cv-00110](#) (E.D. Tenn.), issued an opinion and order in September 2021 granting CIC's motion for a preliminary injunction and enjoining the IRS from enforcing the microcaptive notice ([Notice 2016-66](#), 2016-47 IRB 745) against CIC while the parties litigate the merits of the case.

The district court said that interim relief is warranted because the company "has demonstrated that it is likely to succeed on its claim that Notice 2016-66 is a legislative rule that is invalid because the IRS failed [to] observe notice-and-comment procedures required by the" Administrative Procedure Act.

## The Waiting Game

Taxpayers who are currently undergoing penalty exams may need to be patient and strategic while deciding their next moves, said Brian McManus of Latham & Watkins LLP.

“My view is that it’s going to take quite a while for these issues to make their way through the judicial system,” said McManus. “I think there’s going to be some ups and downs here, and we don’t know where this is all going to shake out. But the IRS is probably not going to move much with respect to penalties until” the courts issue decisions.

McManus said that if his clients are in a position to pay the penalty, he’s advising them to pay and then file a protective refund claim. “Try to get this on the back burner so that we’re not forced into court right away,” he said. “We’re waiting it out and hoping [the taxpayer cases] will be successful. There are avenues to go to court now if your client is inclined to do that.”

Mary E. Wood of Meadows, Collier, Reed, Cousins, Crouch & Ungerman LLP said she’s telling her clients that even with the encouraging signs from the *CIC Services* case, she doesn’t expect IRS Exam or IRS Appeals to budge anytime soon in their position on reportable transaction penalties. “I don’t think there’s anything wrong with us raising the same arguments in Exam or Appeals that are being asserted in *Mann Construction* or *CIC*, depending on the notice and whether it’s a taxpayer or adviser,” Wood said.

“But I think we can preserve our arguments there and get them on the record, understanding that we don’t think the IRS will be receptive to those arguments,” Wood continued. “And then making a strategic decision on how to move forward so we allow the legal landscape to settle, hopefully in favor of taxpayers and material advisers, and perhaps getting notices set aside.”

Paying the penalty and then filing a refund claim is a good option for taxpayers who can afford it, said Wood. “But then you have some clients that simply won’t be in that position, and there I think we just have to push it out as long as you can and see how things do shake out,” she added.