New IRS Practice Unit Explains Penalty Relief

POSTED ON JUL. 10, 2020

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The IRS has released a practice unit explaining the reasonable cause exception for penalties, but some practitioners are questioning the guidance's usefulness.

The practice unit, posted July 2, provides a general overview of the reasonable cause defense against penalty assertions.

Initiated in 2014 as part of the IRS Large Business and International Division's knowledge management efforts, practice units are developed through internal collaboration and designed to serve as both job aids and training materials on various tax issues. LB&I's collection of practice units is housed on the IRS website.

The new guidance on penalty relief, which spans 18 pages, details the penalty provisions for which the reasonable cause defense is available and sets out key factors that examiners should consider when determining whether a taxpayer has reasonable cause and has acted in good faith.

However, the guidance "is a plain vanilla recitation of the Internal Revenue Manual," according to Frank Agostino of Agostino & Associates PC. "It isn't a great training tool because it doesn't give examples of how to apply the rules."

Michael A. Villa Jr. of Meadows, Collier, Reed, Cousins, Crouch & Ungerman LLP said the practice unit seems to be largely a compilation of readily available information. "However, having more sources available to the public on penalty relief is always welcome," he said.

Jenny L. Johnson Ware of McDermott Will & Emery agreed that the practice unit doesn't contain any particularly illuminating or controversial guidance. "From my point of view, the only interesting question is why LB&I put this together," she said. "I'm wondering if there is an effort to train examiners to apply the reasonable cause standards more rigorously, or if this is just a routine update of materials that came out now because it could be done remotely during COVID-19."

"There is no big news here, but I think the practice unit is well organized and provides great guidance," said Yoram Keinan of Kostelanetz & Fink LLP. "It provides a great start for practitioners."

Keinan noted that Treasury and the IRS have in the past provided a handful of highly limited examples regarding reasonable cause in regulations. However, because the universe of what could constitute reasonable cause is so broad, he said he wouldn't expect the IRS to give detailed examples in a practice unit.

"To provide helpful examples, the IRS — with Treasury — must put together lengthy regulations," Keinan said. It wouldn't be in the IRS's best interest to provide detailed examples in a practice unit of what it considers reasonable cause and what it doesn't, he added.

Key Factors

According to the practice unit, the taxpayer's effort to report the proper tax liability is the most important factor in determining reasonable cause. It says that when assessing that effort, examiners should look at all relevant factors, including the nature of the tax investment, the complexity of the tax issue, the taxpayer's education, and their tax adviser's competence.

"In determining whether a taxpayer exercised ordinary business care and prudence, you should consider all the facts and circumstances and review all available information such as the taxpayer's reason, compliance history, length of time and circumstances beyond the taxpayer's control," the guidance says.

The practice unit states that examiners should, at a minimum, look at the three preceding tax years for payment patterns and compliance history. A taxpayer who repeatedly is assessed the same penalty may not be exercising ordinary business care, it says.

"Considering all the facts and circumstances, consider the length of time between the event cited as the reason for noncompliance and when the taxpayer came back into compliance," the guidance says. "The taxpayer's reason should coincide with the timeframe of dates and events that relate to the penalty assertion. While factoring in the circumstances that were beyond the taxpayer's control, consider whether the taxpayer could have foreseen or anticipated the event that caused the noncompliance."

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DOCUMENT ATTRIBUTES

JURISDICTIONS	UNITED STATES
SUBJECT AREAS / TAX TOPICS	PENALTIES
AUTHORS	KRISTEN A. PARILLO
INSTITUTIONAL AUTHORS	TAX ANALYSTS
TAX ANALYSTS DOCUMENT NUMBER	DOC 2020-26232
TAX ANALYSTS ELECTRONIC CITATION	2020 TNTF 132-8