

MLI  
#6**Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654****SUMMARY**

We reviewed 47 decisions issued by federal courts from June 1, 2017, to May 31, 2018, regarding additions to tax for:

- i. Failure to file a tax return by the due date under Internal Revenue Code (IRC) § 6651(a)(1);
- ii. Failure to pay an amount shown on a tax return under IRC § 6651(a)(2);
- iii. Failure to pay installments of the estimated tax under IRC § 6654; or
- iv. Some combination of the three.<sup>1</sup>

The phrase “addition to tax” is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty, and the estimated tax penalty. Twelve cases involved the imposition of the estimated tax penalty in conjunction with the failure to file and failure to pay penalties; 35 cases involved the failure to file or failure to pay penalties without the estimated tax penalty; and there were no cases involving the estimated tax penalty as the only issue.

A taxpayer can avoid the failure to file and failure to pay penalties by demonstrating the failure is due to reasonable cause and not willful neglect.<sup>2</sup> The estimated tax penalty is imposed unless the taxpayer falls within one of the statutory exceptions.<sup>3</sup> Taxpayers were unable to avoid a penalty in 41 of the 47 cases.

**TAXPAYER RIGHTS IMPACTED<sup>4</sup>**

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

**PRESENT LAW**

Under IRC § 6651(a)(1), a taxpayer who fails to file a return on or before the due date (including extensions of time for filing) will be subject to a penalty of five percent of the tax due (minus any credit the taxpayer is entitled to receive and payments made by the due date) for each month or partial month the return is late. This penalty will accrue up to a maximum of 25 percent, unless the failure is due to

1 Internal Revenue Code (IRC) § 6651(a)(3) imposes an addition to tax if the tax required to be shown on a return, but which is not shown, is not paid within 21 calendar days from the date of notice and demand for payment. Because we only identified two cases involving this penalty, we did not include it in our analysis.

2 IRC § 6651(a)(1), (a)(2).

3 IRC § 6654(e).

4 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are also codified in the IRC. See IRC § 7803(a)(3).

reasonable cause and not willful neglect.<sup>5</sup> For the taxpayer to avoid the penalty by showing there was a reasonable cause, the taxpayer must have exercised ordinary business care and prudence.<sup>6</sup> The failure to file penalty applies to income, estate, gift, employment, self-employment, and certain excise tax returns.<sup>7</sup>

When an income tax return is filed more than 60 days after the due date (including extensions), the penalty shall not be less than the lesser of two amounts—100 percent of the tax required to be shown on the return that the taxpayer did not pay on time, or a specific dollar amount, which is adjusted annually due to inflation.<sup>8</sup> The specific dollar amounts are as follows:

- \$215 for returns due on or after 1/1/2019;
- \$210 for returns due on or after 1/1/2018;
- \$205 for returns due between 1/1/2016 and 12/31/2017;
- \$135 for returns due between 1/1/2009 and 12/31/2015; and
- \$100 for returns due before 1/1/2009.

The failure to pay penalty, IRC § 6651(a)(2), applies to a taxpayer who fails to pay an amount shown or required to be shown as tax on the return. The penalty accrues at a rate of half a percent (0.5 percent) per month on the unpaid balance for as long as it remains unpaid, up to a maximum of 25 percent of the amount due.<sup>9</sup> When the IRS imposes both the failure to file and failure to pay penalties for the same month, it reduces the failure to file penalty by the amount of the failure to pay penalty (0.5 percent for each month).<sup>10</sup> The taxpayer can avoid the penalty by establishing the failure was due to reasonable cause; in other words, the taxpayer must have exercised ordinary business care and prudence but nonetheless was unable to pay by the due date, or that paying on the due date would have caused undue hardship.<sup>11</sup> The failure to pay penalty applies to income, estate, gift, employment, self-employment, and certain excise tax returns.<sup>12</sup>

Courts will consider “all the facts and circumstances of the taxpayer’s financial situation” to determine whether the taxpayer exercised ordinary business care and prudence.<sup>13</sup> In addition, “consideration will be given to the nature of the tax which the taxpayer has failed to pay.”<sup>14</sup>

5 IRC § 6651(a)(1), (b)(1). The penalty increases to 15 percent per month up to a maximum of 75 percent if the failure to file is fraudulent. IRC § 6651(f).

6 Treas. Reg. § 301.6651-1(c)(1).

7 IRC § 6651(a)(1).

8 IRC § 6651(a). The IRS typically announces various inflation adjustments by publishing a revenue procedure. See, e.g., Rev. Proc. 2018-18, 2018-10 I.R.B. 392.

9 IRC § 6651(a)(2). Note that if the taxpayer timely files the tax return (including extensions) but an installment agreement is in place, the penalty will continue accruing at the lower rate of 0.25 percent rather than 0.5 percent of the tax shown. IRC § 6651(h).

10 IRC § 6651(c)(1). When both the failure to file and failure to pay penalties are accruing simultaneously, the failure to file will max out at 22.5 percent and the failure to pay will max out at 2.5 percent, thereby abiding by the 25 percent maximum limitation.

11 Treas. Reg. § 301.6651-1(c)(1). Even when a taxpayer shows undue hardship, the regulations require proof of the exercise of ordinary business care and prudence.

12 IRC § 6651(a)(2).

13 Treas. Reg. § 301.6651-1(c)(1). See, e.g., *East Wind Indus. v. U.S.*, 196 F.3d 499, 507 (3d Cir. 1999).

14 Treas. Reg. § 301.6651-1(c)(2).

IRC § 6654 imposes a penalty on any underpayment of estimated tax by an individual or by certain estates or trusts.<sup>15</sup> The law requires four installments per tax year, each generally 25 percent of the required annual payment.<sup>16</sup> The required annual payment is generally the lesser of 90 percent of the tax shown on the return for the current tax year or 100 percent of the tax for the previous tax year.<sup>17</sup>

The amount of the penalty is determined by applying:

- The underpayment rate established under IRC § 6621;
- To the amount of the underpayment;
- For the period of the underpayment.<sup>18</sup>

The amount of the underpayment is the excess of the required payment over the amount paid by the due date. To avoid the penalty, the taxpayer has the burden of proving that one of the following exceptions applies:

- The tax due (after taking into account any federal income tax withheld) is less than \$1,000;<sup>19</sup>
- The preceding tax year was a full 12 months, the taxpayer had no liability for the preceding tax year, and the taxpayer was a U.S. citizen or resident throughout the preceding tax year;<sup>20</sup>
- The IRS determines that because of casualty, disaster, or other unusual circumstances, the imposition of the penalty would be against equity and good conscience;<sup>21</sup> or
- The taxpayer retired after reaching age 62, or became disabled, in the tax year for which estimated payments were required, or in the tax year preceding that year, and the underpayment was due to reasonable cause and not willful neglect.<sup>22</sup>

In any court proceeding, the IRS has the burden of producing sufficient evidence that it imposed the failure to file, failure to pay, or estimated tax penalties appropriately.<sup>23</sup>

## ANALYSIS OF LITIGATED CASES

We analyzed 47 opinions issued between June 1, 2017, and May 31, 2018, where the failure to file penalty, failure to pay penalty, or estimated tax penalty was in dispute. All but eight of these cases were either litigated in the United States Tax Court, or an appeal of a Tax Court decision. A detailed list appears in Table 6 in Appendix 3. Twenty-eight cases involved individual taxpayers and 19 involved businesses (including individuals engaged in self-employment or partnerships).

15 IRC § 6654(a), (l).

16 IRC § 6654(c)(1), (d)(1)(A).

17 IRC § 6654(d)(1)(B). If the adjusted gross income shown on the return of the individual for the preceding taxable exceeds \$150,000, the required annual payment increases to an amount 110 percent of the tax shown on the return of the individual for the preceding tax year (if preceding tax year was 2002 or after). IRC § 6654(d)(1)(C)(i).

18 IRC § 6654(a).

19 IRC § 6654(e)(1).

20 IRC § 6654(e)(2).

21 IRC § 6654(e)(3)(A).

22 IRC § 6654(e)(3)(B).

23 *Higbee v. Comm'r*, 116 T.C. 438, 446 (2001) (applying IRC § 7491(c)). An exception to this rule relieves the IRS of this burden where the taxpayer's petition fails to state a claim for relief from the penalty (and therefore is deemed to concede the penalty). *Funk v. Comm'r*, 123 T.C. 213, 218 (2004).

Of the 19 cases in which taxpayers appeared *pro se* (without counsel), the outcomes generally favored the IRS. In one case, the court granted partial relief to the taxpayer, and in one case, the court granted full relief to the taxpayer. The IRS prevailed in full in the remaining 17 cases. Taxpayers represented by counsel fared slightly better; of the 27 cases in which taxpayers had representation, taxpayers prevailed in full in four cases and were denied relief in the remaining 23 cases.

### Failure to File Penalty

In 41 out of the 46 cases reviewed where the failure to file penalty was at issue, the taxpayers could not prove that the failures to file were due to reasonable cause.<sup>24</sup> Taxpayers provided reasons such as physical injury or mental illness, reliance on an agent, and electronic filing errors as a basis for reasonable cause. Circumstances suggesting reasonable cause are typically outside the taxpayer's control.<sup>25</sup>

#### *Physical Injury or Mental Illness Defense*

A physical injury or mental illness may provide a basis for a taxpayer to establish reasonable cause for not filing, if the condition affected the taxpayer to such a degree that he or she could not file a tax return on time. When determining whether the condition establishes reasonable cause, the court analyzes how the taxpayer conducted his or her business affairs during the illness.

In *Rogers v. Commissioner*, the Tax Court found that married taxpayers had established reasonable cause for their failure to file their 2009 tax return based on illness.<sup>26</sup> The taxpayers testified that Mr. Rogers was hospitalized for an extended period in 2009 to treat his alcoholism, during which time there was no means of communication between Mr. and Mrs. Rogers.<sup>27</sup> After his release, Mr. Rogers continued to deal with his illness. Mrs. Rogers was preoccupied caring for her husband and taking on substantial additional responsibilities in their businesses.<sup>28</sup> The court also noted that the taxpayers timely filed their income tax returns in prior years under extension, and would have done so for 2009 if they had requested an extension for that year.<sup>29</sup> Mrs. Rogers experienced her own health problems with stress, anxiety, and depression in connection with her husband's illness and subsequent care. Acknowledging that "[i]llness or incapacity of a taxpayer or a member of his immediate family may be reasonable cause for late filing," the court found the taxpayers were not liable for the failure to file penalty.<sup>30</sup>

In contrast, a vague reference to illness does not establish reasonable cause. The taxpayers in *Barrett v. Commissioner* were unable to establish reasonable cause for filing their 2012 and 2014 tax returns late.<sup>31</sup> Although Mr. Barrett referred vaguely to illness as an excuse for not filing the 2014 return before the

24 Taxpayers avoided the failure to file penalty by successfully proving reasonable cause in four cases.

25 *McMahan v. Comm'r*, 114 F.3d 366, 369 (2d Cir. 1997) (citation omitted), *aff'g* T.C. Memo. 1995-547.

26 *Rogers v. Comm'r*, T.C. Memo. 2018-53.

27 *Id.* Mr. Rogers is a tax attorney and a CPA with over 40 years of experience. He has a *juris* doctor degree (J.D.) from Harvard University and a master of business administration degree (M.B.A.) from the University of Chicago. He was a partner at various law firms from January 1998 to May 2008, when he formed Rogers & Associates as a sole proprietorship. Mrs. Rogers has a bachelor's degree in chemistry, a master's degree in biochemistry, an M.B.A., a doctorate in educational administration, and a J.D. Before retiring in 2005, she worked as a high school chemistry and computer science teacher and an associate principal for over 20 years. She was licensed as a real estate broker in 1967 and an attorney in 1991. Since 2009, she represented clients in property tax appeals.

28 *Id.*

29 *Id.*

30 *Id.*

31 *Barrett v. Comm'r*, T.C. Memo. 2017-195.

IRS sent them a notice of deficiency, he did not offer any excuse for the late filing of the 2012 return.<sup>32</sup> The Tax Court found the taxpayers failed to establish reasonable cause for either of the late filings.<sup>33</sup>

### *Reliance on Agent Defense*

When a taxpayer relies on an agent to fulfill a known filing requirement, it does not relieve the taxpayer of the responsibility.<sup>34</sup> Taxpayers have a non-delegable duty to file a tax return on time.<sup>35</sup> In order for reliance on an agent to rise to the standard of reasonable cause for failing to fulfill the filing requirement, the taxpayer must make full disclosure of all relevant facts to the tax professional that he relies upon.<sup>36</sup> In other words, merely hiring a tax professional (*e.g.*, accountant, lawyer, or Enrolled Agent) to handle tax return filing is not enough to establish that the taxpayer used ordinary business care and prudence if there are facts that indicate otherwise.

In *Mazzei v. Commissioner*, the taxpayers entered into complex transactions marketed by the Western Growers Association, a trade association for farmers.<sup>37</sup> The transactions were designed to reduce taxes by routing funds from the Mazzeis' family business through foreign sales corporations and then into Roth Individual Retirement Accounts (IRAs) designed for this purpose.<sup>38</sup> Before entering into these transactions, the taxpayers presented the transaction paperwork to their personal accountant, Mr. Bedke, who approved their participation in the transaction.<sup>39</sup> Mr. Bedke had prepared the Mazzeis' tax returns for several years, had no connection with the Western Growers Association, and no expectation of profits from the taxpayers' transactions.<sup>40</sup> The Mazzeis did not, however, file Forms 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*, to report the transactions for each of the years at issue.

The Tax Court held that the taxpayers established reasonable cause for their failure to timely file the returns and failure to pay the amounts shown on those returns. The Tax Court applied the following three-part test from *Neonatology Associates, P.A. v. Commissioner*:<sup>41</sup>

Reliance on professional advice is reasonable and thus warrants reasonable cause abatement if:

- i. The advisor was a competent professional with sufficient expertise to justify reliance;
- ii. The taxpayer provided necessary and accurate information to the adviser; and
- iii. The taxpayer actually relied on the adviser's judgment in good faith.

The court found Mr. Bedke, a tax partner at an accounting firm where he had practiced for 29 years, was a competent professional with sufficient expertise to justify the Mazzeis' reliance. The Mazzeis

32 *Barrett v. Comm'r*, T.C. Memo. 2017-195.

33 *Id.*

34 The Supreme Court held in *U.S. v. Boyle* that reasonable cause may exist when a taxpayer relies on the erroneous advice of counsel concerning a question of law. To escape liability for the failure to file penalty, the taxpayer bears the heavy burden of proving both (1) that the failure did not result from 'willful neglect,' and (2) that the failure was 'due to reasonable cause.' 469 U.S. 241, 245, 250 (1985).

35 *U.S. v. Boyle*, 469 U.S. 241 (1985). The Court noted that "[i]t requires no special training or effort to ascertain a deadline and make sure that it is met." *Id.* at 252.

36 *Id.*

37 *Mazzei v. Comm'r*, 150 T.C. No. 7 (2018), *appeal docketed*, No. 18-72451 (9th Cir., Sept. 5, 2018).

38 *Id.*

39 *Id.*

40 *Id.*

41 *Neonatology Assocs., P.A. v. Comm'r*, 115 T.C. 43, 99 (2000); *aff'd*, 299 F.3d 221 (3d Cir. 2002).

had provided all the necessary transaction documents to Mr. Bedke.<sup>42</sup> Additionally, Mr. Bedke did not promote, participate in structuring, or profit from the transactions at issue.<sup>43</sup> Accordingly, the court found that the taxpayers reasonably relied on their accountant and therefore, were not liable for the failure to file and failure to pay penalties.<sup>44</sup>

### *Electronic Filing Errors Defense*

In several cases, taxpayers argued they had reasonable cause for failure to file their tax returns due to alleged malfunctions in their tax return electronic filing software. The courts uniformly rejected this defense.<sup>45</sup>

In *Spottiswood v. United States*, married taxpayers attempted to file their joint income tax return electronically using TurboTax software.<sup>46</sup> The IRS rejected taxpayers' return because the social security number and last name of a dependent on the return did not match the IRS's records.<sup>47</sup> TurboTax informed the taxpayers of the electronic filing rejection on or about the same day that they filed the return. However, the taxpayers did not check the email account associated with their TurboTax account, nor did they use the "check e-file status" TurboTax screen to confirm the IRS had accepted their return until many months later.<sup>48</sup> As a result, the court held that the taxpayers failed to establish reasonable cause for failing to file a return.<sup>49</sup>

Circumstances suggesting reasonable cause are typically outside the taxpayer's control.<sup>50</sup> In *Haynes v. United States*, taxpayers argued that the failure of the tax software to notify them when the IRS rejected their return was a circumstance beyond their control.<sup>51</sup> The court rejected this argument, holding that "an alleged software failure does not rise to the level of the Supreme Court's definition of a circumstance beyond Plaintiffs' control—disability, infirmity, objective incapacity—in *Boyle*."<sup>52</sup> Furthermore, the court noted that taxpayers had the option of filing their tax return on paper, electronically, or through any number of tax return preparers.<sup>53</sup> The court was careful in distinguishing cases in which reasonable cause may exist when taxpayers rely on erroneous advice of counsel on a question of law.<sup>54</sup> Accordingly, while it may have been reasonable for the taxpayers to retain an expert accountant to electronically file their return, their decision to do so does not rise to reasonable cause for the abatement of late-filing penalties. This case had generated much interest in the tax practitioner community.<sup>55</sup> On appeal, the Fifth Circuit vacated the judgment and remanded the case back to the district court, holding that it was

42 *Mazzei v. Comm'r*, 150 T.C. No. 7 (2018), *appeal docketed*, No. 18-72451 (9th Cir., Sept. 5, 2018).

43 *Id.*

44 *Id.*

45 See, e.g., *Spottiswood v. U.S.*, 121 A.F.T.R.2d (RIA) 1595 (N.D. Cal. 2018), *appeal docketed*, No. 18-16103 (9th Cir. June 14, 2018); *Haynes v. U.S.*, 119 A.F.T.R.2d (RIA) 2202 (W.D. Tex. 2017), *vacated and remanded*, No. 17-50816 (5th Cir. Jan. 29, 2019).

46 *Spottiswood v. U.S.*, 121 A.F.T.R.2d (RIA) 1595 (N.D. Cal. 2018), *appeal docketed*, No. 18-16103 (9th Cir. June 14, 2018).

47 *Id.*

48 *Id.*

49 *Id.*

50 *McMahan v. Comm'r*, 114 F.3d 366, 369 (2d Cir. 1997) (citation omitted), *aff'g* T.C. Memo. 1995-547.

51 *Haynes v. U.S.*, 119 A.F.T.R.2d (RIA) 2202 (W.D. Tex. 2017), *vacated and remanded*, No. 17-50816 (5th Cir. Jan. 29, 2019).

52 *Haynes v. U.S.*, 119 A.F.T.R.2d (RIA) 2202, 2017 U.S. Dist. LEXIS 106252, at \*27-28 (W.D. Tex. 2017) (citing *U.S. v. Boyle*, 469 U.S. 241, 250 (1985)), *vacated and remanded*, No. 17-50816 (5th Cir. Jan. 29, 2019).

53 *Haynes v. U.S.*, 119 A.F.T.R.2d (RIA) 2202 (W.D. Tex. 2017), *vacated and remanded*, No. 17-50816 (5th Cir. Jan. 29, 2019).

54 *Id.*

55 See <http://procedurallytaxing.com/delinquency-penalties-boyle-in-the-age-of-e-filing/> (last visited Sept. 4, 2018). The American College of Tax Counsel has filed an *amicus brief* in support of the taxpayers.

not yet necessary to consider whether an exception to the Boyle standard should be created for taxpayers who e-file.<sup>56</sup>

### Failure to Pay an Amount Shown Penalty

The failure to pay penalty is based on the amount shown on the tax return. If the taxpayer did not file a tax return, the IRS can only assess the IRC § 6651(a)(2) penalty if it has introduced a Substitute for Return (SFR) that satisfies the requirements of IRC § 6020(b). During litigation involving an SFR, if the IRS cannot produce the SFR, it fails to meet its burden of production under IRC § 7491 and the taxpayer can avoid a failure to pay penalty.<sup>57</sup>

As with the failure to file penalty, raising a reasonable cause defense to the failure to pay penalty requires that the taxpayer show that she exercised ordinary business care and prudence in the payment of her tax liabilities, but nevertheless was either unable to timely pay the tax or would suffer undue hardship if the payment was made on time.<sup>58</sup> Unsurprisingly, taxpayers often use medical illness or reliance on an agent as the basis for establishing reasonable cause to avoid the failure to pay penalty under IRC § 6651(a)(2), as they do for the failure to file penalty under IRC § 6651(a)(1).

In *Dykstra v. Commissioner*, the taxpayer filed her 2005 return late.<sup>59</sup> The taxpayer testified she became overwhelmed by work and had retained her longtime accountant, who did not prioritize her return.<sup>60</sup> When faced with the stress of the 2007 financial crisis, particularly given her job in real estate, the taxpayer said her delinquent tax returns started accumulating.<sup>61</sup> The taxpayer ultimately hired a new accountant and filed all of her overdue returns; however, the court did not excuse her failure to file her returns and pay the additions to tax.<sup>62</sup> The Tax Court acknowledged the difficult time the taxpayer endured, but held that her explanation did not demonstrate that she exercised ordinary care and prudence in meeting her obligations.<sup>63</sup> As a result, the court sustained the IRS's determinations as to the additions to tax.<sup>64</sup>

In contrast, the taxpayer in *Emery Celli Cuti Brinckerhoff & Abady, P.C. v. Commissioner*, a law firm, established reasonable cause for its failure to file an employment tax return and failure to pay an amount shown.<sup>65</sup> The law firm, Emery, Celli, Brinckerhoff & Abady, LLP (Emery LLP), paid wages to its employees during the first quarter of 1999 and made employment tax deposits for each of them.<sup>66</sup> However, the law firm's payroll service provider that made the employment tax deposits deposited them erroneously under Emery LLP's employer identification number (EIN).<sup>67</sup> The Tax Court held that the

56 *Haynes v. U.S.*, vacated and remanded, No. 17-50816 (5th Cir. Jan. 29, 2019).

57 See *Wheeler v. Comm'r*, 127 T.C. 200, 210 (2006), *aff'd*, 521 F.3d 1289 (10th Cir. 2008).

58 See Treas. Reg. § 301.6651-1(c)(1).

59 *Dykstra v. Comm'r*, T.C. Memo. 2017-156.

60 *Id.*

61 *Id.*

62 *Id.*

63 *Id.*

64 *Dykstra v. Comm'r*, T.C. Memo. 2017-156.

65 *Emery Celli Cuti Brinckerhoff & Abady, P.C. v. Comm'r*, T.C. Memo. 2018-55.

66 *Id.*

67 *Id.*



company nevertheless exercised ordinary business care and prudence.<sup>68</sup> The paramount factor was a timely filed return and timely deposited employment taxes, albeit under an incorrect EIN.<sup>69</sup>

### Estimated Tax Penalty

Courts routinely found taxpayers liable for the IRC § 6654 estimated tax penalty when the IRS proved the taxpayer:

- i. Had a tax liability;
- ii. Had no withholding credits;
- iii. Made no estimated tax payments for that year; and
- iv. Offered no evidence to refute the IRS.

The IRS has the burden under IRC § 7491(c) to produce evidence that IRC § 6654(d)(1)(B) requires an annual payment from the taxpayer.

The estimated tax penalty is calculated with reference to four required installment payments of the taxpayer's estimated tax liability.<sup>70</sup> Each required installment is equal to 25 percent of the taxpayer's "required annual payment."<sup>71</sup> The required annual payment equals the lesser of: (i) 90 percent of the tax shown on the individual's return for that year (or, if no return is filed, 90 percent of the individual's tax for such year); or (ii) if the individual filed a valid return for the immediately preceding tax year, 100 percent of the tax shown on that return (this can increase to 110 percent based on adjusted gross income).<sup>72</sup> The IRS has the burden to produce evidence that IRC § 6654(d)(1)(B) requires an annual payment from the taxpayer.<sup>73</sup> If a taxpayer did not pay enough tax throughout the year, either through withholding or by making estimated tax payments, the IRS will assess a penalty for underpayment of estimated tax.<sup>74</sup>

In *Plato v. Commissioner*, the Tax Court held that the IRS did not meet its burden of showing the taxpayer had an annual required payment.<sup>75</sup> Mr. Plato, the taxpayer, had recently separated from his wife and filed a married filing separately return for the first time during the tax year. If taxpayers, like Mr. Plato, who filed a married filing jointly return for the prior year, file married filing separately returns, the regulations provide a special rule for calculating their required annual payments.<sup>76</sup> Under

68 *Emery Celli Cuti Brinckerhoff & Abady, P.C. v. Comm'r*, T.C. Memo. 2018-55.

69 *Id.*

70 IRC § 6654(c)-(d).

71 IRC § 6654(d)(1)(A).

72 IRC § 6654(d)(1)(B). There are special rules on calculating the required annual payment for taxpayers who filed a married filing jointly return for the prior tax year but are filing married filing separately for the current year, and for taxpayers whose adjusted gross income exceed a certain amount. For instance, if a taxpayer's AGI for 2017 was more than \$150,000 (\$75,000 if the taxpayer's filing status for 2018 is married filing a separate return), the taxpayer must substitute 110 percent for 100 percent. See IRC § 6654(d)(1)(C) and Treas. Reg. § 1.6654-2(e).

73 IRC § 7491(c).

74 The law allows the IRS to waive the penalty if: (1) a taxpayer did not make a required payment because of a casualty event, disaster, or other unusual circumstance and it would be inequitable to impose the penalty, or (2) a taxpayer retired (after reaching age 62) or became disabled during the tax year or in the preceding tax year for which you should have made estimated payments, and the underpayment was due to reasonable cause and not willful neglect. IRC § 6654(e)(3).

75 *Plato v. Comm'r*, T.C. Memo. 2018-7.

76 Treas. Reg. § 1.6654-2(e).



Treasury Regulation § 1.6654-2(e), the taxpayers' prior year tax liabilities are the taxes the spouses would be liable for, if they each filed a married filing separately return for that year.<sup>77</sup>

However, the community property law where Mr. Plato and his wife resided, required that any withholding payments had to be allocated when married spouses chose to file separately. Yet the IRS did not provide evidence of allocation of the adjusted gross income and tax per the return for the prior year between Mr. Plato and his wife. Consequently, although the Tax Court could calculate 90 percent of the taxpayer's tax in the current year under clause (i) of the penalty calculation, it was unable to calculate the number equal to 100 percent of the tax shown on the taxpayer's prior year return under clause (ii). The IRS had the burden to prove the amount of a required annual payment, and failed to carry its burden of production. Thus, the Tax Court did not sustain the estimated tax penalty.<sup>78</sup>

## CONCLUSION

Taxpayers prevailed in full in only five of 47 (nearly 11 percent) of the failure to file, failure to pay, and estimated tax penalty cases analyzed in this report. One taxpayer prevailed in part (two percent), meaning the IRS won nearly 87 percent of the cases. The number of cases, in which failure to file, failure to pay, and estimated tax penalties were at issue, decreased by almost 23 percent from last year, and the portion of cases where the taxpayer received at least some form of relief decreased from 20 percent to 13 percent. This decline may be attributed to the general decline in tax litigation in recent years.<sup>79</sup>

It is critical that IRS employees thoroughly analyze all facts and circumstances of a case when assessing reasonable cause claims rather than solely relying on the Reasonable Cause Assistant (RCA) software,<sup>80</sup> which is designed to help IRS employees make fair and consistent abatement determinations.<sup>81</sup> The RCA program allows IRS employees to override the results in certain circumstances, but employees must understand the definition of reasonable cause to apply the override.<sup>82</sup> Thus, a close review by an employee is essential to ensure that the failure to file penalty or the failure to pay penalty is imposed appropriately. Additionally, it is imperative that taxpayers verify the IRS has accepted their electronically filed return. Although electronic filing instead of mailing has some benefits, to include receiving a refund much quicker, the IRS can reject an electronically-filed return for a wide range of reasons. In those cases, taxpayers will need to figure out the error and try filing again.

<sup>77</sup> Treas. Reg. § 1.6654-2(e)(1)-(2), Example (1).

<sup>78</sup> *Plato v. Comm'r*, T.C. Memo. 2018-7.

<sup>79</sup> David McAfee, *Tax Court: Tax Court Caseload Drops as Enforcement Lags: Former Chief Judge* 142 DTR 8 (July 24, 2018). Former Chief Judge L. Paige Marvel noted that the Tax Court's inventory is dropping, due in part to lax enforcement. This trend could correlate with the fewer litigated lien cases in the U.S. District Courts. See also Most Litigated Issue: *Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403*, *infra*.

<sup>80</sup> The Reasonable Cause Assistant (RCA) can only consider failure to file or failure to pay penalties for certain individual tax returns.

<sup>81</sup> National Taxpayer Advocate 2010 Annual Report to Congress 198 (Most Serious Problem: *The IRS's Over-Reliance on Its "Reasonable Cause Assistant" Leads to Inaccurate Penalty Abatement Determinations*). See also IRS, *Reasonable Cause Assistant (RCA) Usability Test Final Report Summary* 4 (May 28, 2010). The test showed that employees using the RCA determined penalty abatement requests correctly in only 45 percent of the cases. An even more disturbing finding was that all of the employees in the study believed they were making correct legal determinations based on reasonable cause.

<sup>82</sup> Internal Revenue Manual 20.1.1.3.6.10(3) (Nov. 25, 2011) ("[F]air and consistent application of penalties requires employees to make a final penalty relief determination consistent with the RCA conclusion ... [U]nderstanding that the individual facts and circumstances vary for each case and that there may be unique facts and circumstances in certain cases that RCA cannot consider, an 'override (abort)' function is available in RCA.")

As previously recommended by the National Taxpayer Advocate, Congress should amend IRC § 6404 to authorize the Secretary of the Treasury to grant a one-time abatement of the failure to file penalty (IRC § 6651(a)(1)) and failure to pay penalty (IRC § 6651(a)(2)) for first-time filers and taxpayers who have a consistent history of compliance, where no countervailing factors are present.<sup>83</sup> Finally, taxpayers are encouraged to review their W-4 forms and make any adjustments if they have too little withheld from their paychecks. In a July 2018 report, the Government Accountability Office estimated that 21 percent—or 30 million taxpayers—will be under withheld and need to make up the difference when they file their 2018 tax return.<sup>84</sup> In response, the IRS will not apply estimated tax penalties to underpayments of tax as a result of the Tax Cuts and Jobs Act (TCJA). The National Taxpayer Advocate applauds these efforts by the IRS, but has noted there is no information on how the IRS will determine that an underpayment is pursuant to the TCJA nor how it will otherwise apply the policy. In sum, to promote voluntary compliance and to uphold a taxpayer's *right to a fair and just tax system* and the *right to pay no more than the correct amount of tax*, the facts of taxpayers' individual cases must be carefully considered.

---

83 National Taxpayer Advocate 2001 Annual Report to Congress 188.

84 See Government Accountability Office (GAO), GAO-18-548, *Federal Tax Withholding: Treasury and IRS Should Document the Roles and Responsibilities for Updating Annual Withholding Tables* (July 2018), <https://www.gao.gov/assets/700/693582.pdf>.