

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

TAXPAYER RIGHTS IMPACTED¹

- *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*

OVERVIEW

Under IRC §§ 6651(a)(1), (a)(2), and 6654, the IRS may impose penalties on taxpayers when they fail to timely file a tax return, fail to pay an amount shown as tax on a return, or underpay installments of estimated taxes, respectively.² When these penalties should be imposed and how they are calculated is relatively straightforward. Historically, in the majority of litigated cases that we have reviewed, taxpayers were unrepresented (*pro se*) and the IRS has prevailed in most of them. This trend continued once again in our review of litigated cases where a written opinion was issued between June 1, 2019, and May 31, 2020.

Of the 31 cases we reviewed, taxpayers appeared *pro se* in 20, and in these cases, the outcomes almost always favored the IRS. Taxpayers were represented in the only case in which the court ruled in their favor.

During our reporting period, between June 1, 2019, and May 31, 2020, there were a total of 24,064,628 taxpayers who had penalties imposed due to the failure to timely file a tax return, failure to pay an amount shown as tax on a return, or underpayment of installments of estimated taxes.³ Figure 2.7.1 breaks down the total for individual and business taxpayers and also shows the number of reasonable cause assistant abatements for the relevant penalties. The largest total category of abatements was for individual taxpayers with 176,308 abatements for taxpayers who had failed to pay an amount on a tax return due to a reasonable cause.⁴ During this same period, taxpayers petitioned Tax Court in 127 cases where the failure to timely file a tax return penalty (delinquency penalty) and/or the estimated tax penalty was an issue during the examination.⁵

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

2 The failure to file (referred to as “FTF”) penalty, failure to pay (referred to as “FTP”) penalty, and the failure to pay estimated taxes (referred to as “FTE”) penalties have appeared on our top ten Most Litigated Issues list since 2003.

3 Obtained from the FTF, FTP, and FTE Assessment and Reasonable Cause Assistant Abatement and Abatement Transactions dated files between June 1, 2019, and May 31, 2020, posted as of cycle 202019 on Individual Master File (IMF) and Business Master File (BMF).

4 *Id.*

5 IRS Appeals response to TAS information request (Dec. 3, 2020) showing cases petitioned to Tax Court between June 1, 2019, and May 31, 2020. TAS matched this data to the cases identified by examination where the failure to timely file a tax return penalty (delinquency penalty) and/or the estimated tax penalty was recommended as recorded in the Examination Operational Automation Database on the IRS Compliance Data Warehouse (CDW) (Dec. 2020).

FIGURE 2.7.1, Total Number of FTF, FTP, and FTE Penalties Imposed and Total Abatements Between June 1, 2019, and May 31, 2020⁶

Penalty Type	Distinct Number of Taxpayers	Reasonable Cause Assistant Abatements ⁷
Individual Master File		
FTF	2,272,265	63,994
FTP	12,253,704	176,308
FTE	6,352,322	N/A
Business Master File		
FTF	1,161,542	1,568
FTP	1,715,744	4,819
FTE	309,051	N/A

ANALYSIS OF LITIGATED CASES

In all but two of the 31 cases reviewed, taxpayers raised reasonable cause as their reason for failing to file a tax return by the due date or failing to timely pay an amount shown or required to be shown as tax on a return.⁸ In only one of the 29 cases where reasonable cause was raised did the taxpayer prevail.⁹ In regard to the six cases where penalties were imposed for underpayment of an estimated tax under IRC § 6654, the IRS was able to show in five of those cases that the taxpayer had a required annual payment,¹⁰ and no evidence was presented to show that the taxpayers qualified for any of the statutory exceptions to the penalty.¹¹ Thus, the penalty was imposed in all five of these cases. In the sixth case, the taxpayer prevailed because the IRS

6 Obtained from the FTF, FTP, and FTE Assessment and Reasonable Cause Assistant Abatement and Abatement Transactions dated files between June 1, 2019, and May 31, 2020, posted as of cycle 202019 on the IRS, CDW Individual Master File and Business Master File database tables.

7 The penalty may be abated in certain circumstances where the taxpayer can show that one of several exceptions set out in IRC § 6654(e)(1), (2) or (3) apply. Internal Revenue Manual 20.1.3.2.7.1, Estimated Tax Penalty and Reasonable Cause (Dec. 10, 2013), provides guidance as to when the penalty under IRC § 6654 can be abated, noting that underpayment of estimated tax cannot be removed or waived for reasonable cause alone. The penalty for underpayment of estimated tax generally is not waived as a result of disaster. However, in the case of a federally declared disaster area, “the Secretary may specify a period of up to one year that may be disregarded” in determining whether estimated tax payments were paid on time.

8 Treas. Reg. § 301.6651-1(c)(1). If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to reasonable cause. *Id.* A failure to pay penalty will be abated due to reasonable cause to the extent that the taxpayer has made a satisfactory showing that he or she exercised ordinary business care and prudence in providing for payment of the tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship if he or she paid on the due date. *Id.*

9 *Estate of Skeba v. U.S.*, 432 F.Supp.3d 461 (D.N.J. 2000).

10 See *Collins v. Comm’r*, T.C. Memo. 2020-50; *Hayes v. Commissioner*, T.C. Memo. 2019-147, *appeal docketed* (9th Cir. Apr. 15, 2020); *U.S. v. Beckwith*, 124 A.F.T.R.2d (RIA) 6896 (D. Maine 2019); *Williams v. Comm’r*, 795 F. App’x 920 (5th Cir. 2019).

11 To avoid an IRC § 6654 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; 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; it is determined that because of casualty, disaster, or other unusual circumstances, the imposition of the penalty would be against equity and good conscience; or 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. IRC § 6654(e)(1), (2), (3).

failed to meet its burden of production to show the taxpayer had a required annual payment payable in installments.¹²

Benton v. Commissioner illustrates the types of reasonable cause arguments that are most commonly raised by taxpayers. Taxpayers argued they had reasonable cause for failing to timely file their tax return due to a confluence of personal and financial difficulties, including a family member's serious illness and the loss of Mrs. Benton's job. However, the court held that the taxpayers did not act with ordinary business care and prudence, because despite these personal challenges, the taxpayers were able to continue operation of a family picture framing business, and the taxpayer's wife held down a temporary job.¹³ *Willett v. U.S.* provides another example of a typical reasonable cause defense.¹⁴ Here, taxpayers argued they had reasonable cause for failing to file and failing to pay because their certified public accountant (CPA), who possessed the original copies of their tax documents, became seriously ill and was unable to complete their 2014 tax return on time. However, the court determined that reliance on a CPA was not "reasonable cause" under *Boyle*.¹⁵ These court opinions show what facts and circumstances typically establish reasonable cause.

A less conventional argument was raised in *Estate of Skeba v. U.S.* where the taxpayer was assessed a penalty in the amount of \$450,959.50 for failing to timely file the estate's tax return, despite timely paying the taxes due.¹⁶ The taxpayer's primary argument in this case was that the failure to file penalty could not be calculated when reading IRC § 6651(a)(1) together with IRC § 6651(b)(1). In other words, the late filing penalty calculated by using the formula in subsection (a)(1) should be based on the net amount due on the date prescribed for payment as set forth in subsection (b)(1).¹⁷ Because the taxpayer had already paid the taxes due prior to filing the estate tax return, the return showed no amount due for which the failure to file penalty could be based.¹⁸ The court agreed with the taxpayer, and held that no failure to file penalty could be calculated because there was no tax due.

CONCLUSION

The nearly unanimous rulings in favor of the IRS illustrate the case law is well established, and the statutory and regulatory guidance is exhaustive. Despite this clarity in the law, year after year, several taxpayers continue to challenge the imposition of these penalties, and most of them are unsuccessful. To ensure taxpayers are fully aware of the types of situations rise to the level of reasonable cause, the IRS should consider better communicating with taxpayers as to what constitutes "reasonable cause." For example, IRS Notice 746, Information About Your Notice, Penalty and Interest, merely informs taxpayers to submit a written statement as to why the penalty should be removed, and the IRS will consider if it is an "acceptable reason."¹⁹ The IRS could improve this notice by providing taxpayers with a more in-depth description of what is "reasonable

¹² *Frost v. Comm'r*, 2020 WL 70716 (T.C. Jan. 7, 2020).

¹³ *Benton v. Comm'r*, T.C. Summ. Op. 2020-12.

¹⁴ *Willett v. U.S.*, 2020 U.S. Dist. LEXIS 32126 (N.D. Cal. Feb. 25, 2020).

¹⁵ *U.S. v. Boyle*, 469 U.S. 241, 245 (1985). The Supreme Court held in *Boyle* that a taxpayer's reliance on an agent to file a return did not constitute reasonable cause for late filing, but reasonable cause may exist when a taxpayer relies on the erroneous advice of counsel concerning a question of law. 469 U.S. 241, 245, 250 (1985).

¹⁶ *Estate of Skeba v. U.S.*, 432 F. Supp. 3d 461 (D.N.J. 2020).

¹⁷ *Id.* The taxpayer also raised a reasonable cause argument in this case for failing to timely file its estate tax return. The taxpayer prevailed in this argument as well.

¹⁸ The failure to file penalty would be based on the net amount due shown on the return minus any credits and any amount paid on or before the date prescribed for payment.

¹⁹ IRS Notice 746, Information About Your Notice, Penalty and Interest (June 2020).

cause,” along with several examples that illustrate what types of situations do and do not rise to the level of reasonable cause.

Recommendation to Mitigate Disputes

The National Taxpayer Advocate recommends that the IRS:

1. Review and revise notices and publications where appropriate to provide more examples of circumstances that constitute reasonable cause to better educate taxpayers.