

# Penalties Above 20%: What Are They, When Are They Applied, and How Do You Defend?

CAROLINE D. CIRAOLO  
*KOSTELANETZ & FINK LLP*  
WASHINGTON, D.C.

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UNIVERSITY OF TEXAS SCHOOL OF LAW  
65<sup>TH</sup> ANNUAL TAXATION CONFERENCE

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## The Growth of Penalties

### Purpose of penalties

- “Penalties exist to encourage voluntary compliance by supporting the standards of behavior required by the [Code].”
- Internal Revenue Manual (“IRM”) 20.11.2 (Feb. 22, 2008)
- Not intended as a revenue raiser

### More than 150 civil penalties authorized

- More than 10-fold increase from the 13 penalties in 1954 Code

### Statistics (FY 2016)

- IRS assessed 29.3 million civil penalties totaling \$27.3 billion
- Approximately \$12.1 billion assessed against individuals, estates, trusts
- IRS abated 5.2 million civil penalties totaling \$8.9 billion

# Developments in the Burden of Production

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## Burden of Production Updates

I.R.C. § 6751(b)(1)

- “No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.”
- Not applicable to:
  - Additions to tax under I.R.C. §§ 6651, 6654, or 6655; and
  - Other penalties automatically calculated via electronic means
- TIGTA 2013 Report Re: Preparer Penalties
  - 8% noncompliance rate in preparer context
  - Prevalence in deficiency cases?

# Burden of Production Updates

- Deficiency cases:
  - Chai v. Commissioner*, 851 F.3d 190 (2d Cir. 2017)
    - "[W]e hold that § 6751(b)(1) requires written approval of the initial penalty determination no later than the date the IRS issues the notice of deficiency (or files an answer or amended answer) asserting such penalty."
    - "[W]e further hold that compliance with § 6751(b) is part of the Commissioner's burden of production and proof in a deficiency case in which a penalty is asserted."
    - "Read in conjunction with § 7491(c), the written approval requirement of § 6751(b)(1) is appropriately viewed as an element of a penalty claim, and therefore part of the IRS's *prima facie* penalty case."
  - But see Graev v. Commissioner*, 147 T.C. No 16 (2016)
    - "Because respondent has not yet assessed the section 6662 penalties at issue in this [deficiency] case, it is premature to consider whether respondent has satisfied section 6751(b)."
- CDP cases:
  - Graev v. Commissioner*, 147 T.C. No. 16 (2016)
    - "We do not foreclose the possibility that a taxpayer who believes that a penalty has been assessed in violation of 6751(b)(1) might raise this issue in a postassessment collection due process (CDP) proceeding."

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# FOIA and Discovery-Related Requests

Taxpayer Name: [REDACTED] Examiner: [REDACTED]  
 TIN: [REDACTED] Date: [REDACTED]  
 Tax Form: [REDACTED]  
 Tax Year (s): [REDACTED]

**CIVIL PENALTY APPROVAL FORM**

Conclusion: ☒ appropriate ☐ not below

Reason(s) for Non-Assertion of Penalty(s): IRM 4.10.6.7(1)  
 No Change or Refund Case

Deficiency Case (Explanation required when adjustments made and penalties are not asserted. The applicable exceptions to the penalty must be documented)

Reason(s) for Assertion of Penalty(s) IRM 4.10.6.7(1)

This case involves a donation of a *Fayate Element* which was taken as a Charitable Contribution. The partnership has failed to substantiate the deduction taken. The penalty is being issued in accordance with IRM 4.10.6.7(1) - Gross Valuation Mismatch.

Group Manager Signature: [REDACTED] Date: [REDACTED]

380-Penalty Approval Form  
Rev. 6/2016

Worksheet 4 300 -1.1

U.S. 1041 24-7

| IRB   | Penalty   | IRM                                | Assess<br>Penalty<br>Yes/No | Reference |
|---|---|------------------------------------|-----------------------------|-----------|
| <b>Penalties Not Requiring Group Manager Approval</b>           |   |                                    |                             |           |
| 6651(b)(1)  | Failure to file information and non-filing returns (Local Street available)                       | 20.1.2.2.7                         | X                           |           |
| 6651(b)(2)  | Failure to Pay  | 20.1.2.2.8.4<br>and<br>20.1.2.2.10 | X                           |           |
| 6654  | Estimated Tax - Individual  | 20.1.3.3                           | X                           |           |
| 6655  | Estimated Tax - Corporate   | 20.1.3.3                           | X                           |           |
| <b>Penalties Requiring Group Manager Approval</b>               |   |                                    |                             |           |
| 6651(b)   | Employment Failure (in IRM 4.10.6.7(1))   | 20.1.2.2.7.1                       | X                           |           |
| 6651(c)   | Negligence (if not street available)  | 20.1.3.1                           | X                           |           |
| 6652(a)   | Substantial Understatements (Local Street available)  | 20.1.3.2                           | X                           |           |
| 6652(b)   | Other Accuracy Related  | 20.1.3.1                           | X                           |           |
| 6652(c)   | Gross Valuation Mismatch  | 20.1.3.4                           | X                           |           |
| 6652(d)   | Accuracy Related Penalty on Understatements with Respect to Reportable Transactions               | 20.1.3.13                          | X                           |           |
| 6107A   | Failure to Include Reportable Transactions  | 20.1.3.13                          | X                           |           |
|   | (Inclusion with Return or Statement (see 6107A))  | and 4.3.2                          | X                           |           |
| 6653  | Failure to Include Reportable Transactions  | 20.1.3.13                          | X                           |           |
|   | (Failure to Include Reportable Transactions)  | 20.1.3.13                          | X                           |           |
| <b>Consideration of Preparer/Practitioner/Advisor Penalties</b> |   |                                    |                             |           |
| 6654(a)   | Preparer Penalties - Understatement Due to Unsubstantiated Deductions (Local Street available)    | 20.1.6.3.7                         | X                           |           |
| 6654(b)   | Preparer Penalties - Understatement Due to Valuation or Reporting Errors (Local Street available) | 20.1.6.3.10                        | X                           |           |
| 6654(c)   | Failure to Furnish Copy to Employer   | 20.1.6.4.1                         | X                           |           |
| 6654(d)   | Failure to Furnish Copy to Taxpayer   | 20.1.6.4.2                         | X                           |           |
| 6654(e)   | Failure to Furnish Copy to Third Party  | 20.1.6.4.3                         | X                           |           |
| 6654(f)   | Failure to Furnish Copy to Employer   | 20.1.6.4.4                         | X                           |           |
| 6654(g)   | Failure to Maintain Records of Preparer's Employment  | 20.1.6.4.5                         | X                           |           |
| 6654(h)   | Registration of Preparer's Fictitious Office  | 20.1.6.4.6                         | X                           |           |
| 6654(i)   | Failure to Obtain and Signify for EIC   | 20.1.6.4.7                         | X                           |           |
| 6109  | Provision of False Information  | 20.1.6.10                          | X                           |           |
| 6751  | Failure to Furnish Information Regarding Reportable Transactions                                  | 20.1.6.10                          | X                           |           |
| 6752  | Failure to Furnish Information Regarding Reportable Transactions                                  | 20.1.6.10                          | X                           |           |
| 6753  | Failure to Maintain List of Advisors with Respect to Reportable Transactions                      | 20.1.6.16                          | X                           |           |
| 6754  | Unauthorized Disclosure or Use of Information   | 20.1.6.17                          | X                           |           |

Rev. 9/2011

Worksheet 4 -1.2

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