Penalty Games: Reducing IRS Penalties

by

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INTRODUCTION

Procedural Requirements for Imposition of Penalties and Additions to Tax
The Internal Revenue Service Restructuring Act required that each notice imposing a penalty include the name of the penalty, the Code section imposing the penalty, and a computation of the penalty. The Act also requires the specific approval of IRS management to assess all non-computer generated penalties unless excepted. This provision does not apply to failure to file penalties, failure to pay penalties, or to penalties for failure to pay estimated tax. The provision was effective with respect to notices issued, and penalties assessed, after December 31, 2000. [Act ’3306] [IRC ’6751]

FAILURE TO FILE TAX RETURN OR PAY TAX

1.10 The Failure to File and Failure to Pay Penalties are:

1. IRC Section 6651(a) Failure to File a Return
2. IRC Section 6651(a)(1) Failure to File a Tax Return
3. IRC Section 6651(a)(2) Failure to Pay a Tax
4. IRC Section 6651(a)(3) Failure to Pay a Tax within 10 days of Notice and Demand
5. IRC Section 6651(d) Increase in the Penalty for Failure to Pay in Certain Cases
6. IRC Section 6651(f) Increase in the Penalty for Fraudulent Failure to File
7. IRC Section 6698 Failure to File a Partnership Return

1.20 Common Features
Generally, a failure to file (FTF) and/or failure to pay (FTP) penalty discussed in this chapter is based on the amount of tax required to be shown on a late-filed or late paid return, reduced by any portion of the tax paid on or before the prescribed due date of the return. An exception to this general rule is the Failure to File a Partnership return, IRC section 6698, which is based on a penalty of $50 per month, per partner for each month the return is late.

1.30 Coordination between FTF and FTP Penalty Rates

1. If both the FTF (under IRC section 6651(a)(1)) and FTP (under IRC section 6651(a)(2)) penalties apply, the FTP penalty amount is allowed as an offset against the FTF penalty for any month in which both apply. When this occurs, the combined penalty rate for the month will not exceed five percent.

2. For example; if the FTP penalty rate of one-half of one percent (.005) is applicable, the FTF penalty would be assessed at 4.5 (.045) percent.
3. When both the FTP penalty and minimum failure to file penalty apply (income tax returns only), the minimum failure to file penalty is not reduced by the amount of the FTP penalty.

1.40 Who Asserts
Generally, all areas of the Service may assert or assess the penalty, based on the circumstances at the time the return is received. On a delinquent tax return mailed to the Service after the due date of the return:

1. Master File assesses any appropriate FTF and/or FTP penalty at the time the tax is assessed and the taxpayer will be sent a balance due notice.

2. Additions to tax (penalty and interest) will accrue.

1.50 Extension of Time to File

1. General Rule: IRC section 6081 and the related regulations provide for a reasonable extension of time to file a return.

2. That "reasonable extension" is not to exceed 6 months (unless the taxpayer is overseas).

   A. If the taxpayer has a valid extension of time for filing a return, that taxpayer is not liable for the FTF penalty for the duration of the extension period. The computation of the FTF penalty begins immediately after the extended due date.

   B. However, an extension of time to file is not an extension of time to pay. Generally, once the signed return is received, the FTP penalty will be computed from the original due date of the return to the date the tax is paid.

   C. Individuals are granted the automatic four month extension of time to file if the following conditions are satisfied: (Treas. Regs. 1.6081-1 and 1.6081-4 and 4T)

      (1) The individual must have completed Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return.

      (2) Signed the request as required in IRC section 6061, Signing of returns and other documents by individuals.

      (3) Filed the application on or before the due date of the return.

      (4) Effective for tax year 1991 and prior: (1) the application must have shown the amount of tax properly estimated to be due; and (2) the amount
properly estimated to be due, must have been paid with the application.

(5) Effective for the tax year 1992 and subsequent, Notice 93-22, 1993-1 C.B. 305, issued April 7, 1993, granted individuals a four month extension of time to file even if they are unable to pay the amount of tax properly estimated to be due. They must however: (1) complete and file the Form 4868 prior to the original due date of the return; (2) sign the request; and (3) properly estimate the amount of tax due.

1.60 Received Date, IRC Section 7502

1. A return is considered timely, if received prior to, or on, the due date or extended due date of the return.

2. U.S. Postal Service. Consider a return timely-filed if postmarked by the U.S. Postal Service by the original or extended due date.
   
   A. A postmark with a date after the prescribed due date is late.
   
   B. When more than one United States Postal Service postmark date appears on an envelope, consider the earlier postmark date as the date the return was mailed.

3. Privately Metered Mail. In general, consider a return timely filed if it contains a postal meter stamp that:
   
   A. Bears the date on or before the last date (or last day of the period) prescribed for filing the return, and
   
   B. The return is received not later than the time the return would normally have been received if it had been mailed on the last date (or last day of the period) prescribed for filing the return.

4. If the return is received after the normal time, the taxpayer must prove the factors in IRC section 301.7502-1(c)(iii)(b) which in general states:
   
   A. The document must show a postmarked date that is on or before the last day of the period prescribed for filing the document.
   
   B. The document must be received by the Service not later than the time the document would have been received if it were postmarked at the same point of origin by the United States Post Office.
   
   C. In addition, the person who is required to file the document must show: the document was deposited before the last collection of the mail (from the place of deposit) on or before the last day prescribed for filing the document, any
delay in receiving the document was due to a delay in the transmission of the mail, and caused the document to be received after the due date of the document.

5. Designated Private Delivery Services. Section 1210 of the Taxpayer Bill of Rights 2 (TBOR 2), Pub. L. No. 104-168, 110 Stat. 1452, added subsection (f) to IRC section 7502. This provision authorizes the Service to expand the "timely mailing as timely filing/paying" rule to certain private delivery services.

1.70 Definition of Month

1. If the date prescribed for filing a return is the last day of a calendar month, each succeeding calendar month or (fraction thereof) during which the failure to file or pay continues is a month for the purposes of the FTF/FTP penalty. For example, when a return is due January 31, 1989, the first month ended on February 28, and the succeeding months ended on March 31, April 30, etc.

2. If the date prescribed for filing the return or paying the tax is other than the last day of the calendar month, the period ends with the corresponding day in the following month.

3. If there is no corresponding day, consider the last day of the following month as the ending date.

4. Example: The failure to pay due date falls on January 30, 1992,

   A. 1992 is a leap year. February has no corresponding due date.

   B. The period from January 30th through the last day of the following month (February 29, 1992) shall be considered a month for the purposes of the FTF and FTP penalty.

   C. If the tax remains unpaid, the FTP penalty due date will fall on the 30th day of each succeeding month.

5. If a return is not timely filed or the tax is not timely paid, the fact that the date prescribed for filing the return or paying the tax, or the corresponding date in any succeeding calendar month, falls on a Saturday, Sunday, or a legal holiday is immaterial in determining the number of months for the FTF/FTP penalty. Treas. Reg. 301.6651-1(b)(3).

1.80 Net Tax Due

1. The net tax amount is the amount of tax required to be shown on the return less allowable credits, such as general business credits, foreign income tax credits, SIC and fuel tax credits. This amount is reduced by payments made on or before the
2. The penalty applies not only to tax shown on a taxpayer's original return, but also to any additional tax later found due on the return.

3. The net tax amount required to be shown on the return includes all income taxes as well as employment taxes. For example, the uncollected employee FICA tax on tips is a tax required to be shown on Form 1040, Individual Tax Return; thus, this uncollected FICA tax on tips should be included in the net tax amount.

4. When computing the net tax amount, the IRS will not consider amounts which were paid after the due date of the return, but before the date of filing.

1.90 Minimum Failure to File
For late returns a minimum FTF penalty applies to all individual and corporate income tax returns delinquent for more than 60 days. The minimum FTF penalty shall not be less than the lesser of: $135.00 or 100 percent of the amount required to be shown as tax on the return.

1.95 Penalty for Failure to File Income Tax Return Increased
If you do not file your return by the due date (including extensions) you may have to pay a failure-to-file penalty. For income tax returns required to be filed after 2008, the failure-to-file penalty for returns filed more than 60 days after the due date (including extensions) is increased. In this situation, the minimum penalty is the smaller of $135 or 100% of the unpaid tax.

1.100 Failure to File a Tax Return IRC Section 6651(a)(1)
IRC section 6651(a)(1) imposes a penalty for failure to file (FTF) a tax return, by the date prescribed (taking into consideration any extension of time for filing), unless it is shown that the failure is due to reasonable cause and not due to willful neglect.

1.110 Penalty Computation
To calculate the penalty:

1. determine the penalty period (number of months including a part of a month

2. determine the penalty rate (4 1/2 or 5 percent);

3. determine the net tax due for each month (including a part of a month) the penalty is applicable; and

4. Multiply the number of months (including a part of a month) the return is past due, times the penalty rate, times the net tax due.
1.120 Penalty Period
The penalty period extends from the prescribed due date, including valid extensions, to the date the Service receives the return.

1. The prescribed due date is the date taxpayers are required to file their returns.

2. If the due date falls on a Saturday, Sunday, or legal holiday, and the return is filed by the next business day, consider it filed on the due date.

3. If the taxpayer has a valid extension of time for filing a return, he/she is not liable for the FTF penalty for the duration of the extension period.

1.130 Penalty Rate

1. Generally, the FTF penalty is 5 percent of the amount of the tax required to be shown on the return for each month, or fraction thereof, that the failure continues, not to exceed 25 percent of the tax.

2. When the FTP penalty under IRC section 6651(a)(2) also applies, the FTF penalty of 5 percent (.05) is reduced by 1/2 of 1 percent per month to 4 1/2 (.045) percent for each month or part of a month that the FTF and FTP both apply.

3. Be aware, that both the FTF and the FTP penalties may apply at the full rate, for the same amount of money, but for different periods in time.

1.140 Tax (FTP) IRC Section 6651(a)(2)

1. IRC section 6651(a)(2) imposes a FTP penalty if the tax shown on any return, other than an information return, is not paid by the due date of that return. The FTP penalty under this provision applies to original and amended returns filed by the taxpayer. This penalty applies to the following returns:

   A. Income tax returns;
   B. Employment tax returns;
   C. Excise tax returns;
   D. Gift tax returns;
   E. Estate tax returns;

2. It does not apply to:

   A. Information returns required under Chapter 61, Subchapter A, Part III;
   B. Payments of estimated tax;
   C. Partnership returns.
1.150 Penalty Period
The period for computing the IRC Section 6651(a)(2) penalty, which applies to original returns, is from the due date of the return until the tax is paid.

1.160 Penalty Rate
IRC section 6651(a)(2) provides that the FTP penalty be assessed at one-half of 1 percent (.005) of the unpaid tax for the first month the penalty applies and an additional one-half of 1 percent (.005) for each additional month or fraction of the month the tax is unpaid, not to exceed 25 percent of the tax.

1.170 Failure to Pay Tax IRC Section 6651(a)(3)

1. IRC section 6651(a)(3) imposes a FTP penalty on any tax required to be reported on a return, other than information returns, but was not reported on the return.

2. The FTF penalty is not reduced by the FTP penalty imposed under IRC section 6651(a)(3).
   A. The FTF penalty will be computed from the original due date of the return for up to five months.
   B. The FTP penalty imposed under IRC section 6651(a)(3) begins with the assessment (23C) date and continues until the additional tax is paid, not to exceed 25 percent of the tax.
   C. Therefore, the FTF and FTP penalties may be assessed on the same amount of unpaid tax, but for different periods of time.

3. For the first notice and demand (first balance due notice) made:
   A. Prior to January 1, 1997, the FTP penalty, under IRC section 6651(a)(3), was assessed when payment was not made within 10 days of notice and demand.
   B. After December 31, 1996, the FTP penalty, under IRC section 6651(a)(3), is assessed if payment is not made within 21 calendar days (or 10 business days if the balance due amount equals or exceeds $100,000) of notice and demand.

1.180 Net Amount Due
Net amount due as it relates to IRC section 6651(a)(3) is the amount of tax stated in the balance due notice. For purposes of computing the FTP penalty, the net amount due may be reduced by any payments made after the balance due notice but prior to the beginning of the following month.
1.190 IRC Section 6651(d) Increase in the FTP

1. IRC section 6651(d) increases the FTP penalty under IRC section 6651(a)(2) or (3) on any tax required to be reported on a return, from one-half of one percent (.005) to one percent (.01) of the tax after either:

   A. The day, 10 days after the date notice of intent to levy (IRC section 6331(d)), or
   B. The day on which notice and demand for immediate payment is given (IRC section 6631(a)).

2. The increased penalty rate (1 percent) applies to all subsequent assessments on that module. However, once a module is fully paid, a later assessment will accrue at the one-half of one percent rate until notice of intent to levy is sent.

1.200 Failure to Pay Penalty When Paying in Installments Decreased
Taxpayers who make '6159 installment payments under an agreement with IRS are now subject to a '6651(a) .0025 percent a month penalty instead of .0050 percent a month penalty for failure to pay taxes if the individual filed the tax return in a timely manner, including extensions (Act '3303; new Code '6651(h); effective for purposes of determining additions to the tax for months beginning after December 31, 1999).

1.210 Penalty Calculations

Example: Failure to File and Failure to Pay Form 1040

Return Due Date (041599) – Tax year 1998

<table>
<thead>
<tr>
<th>Code</th>
<th>Date Received</th>
<th>Amount</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>TC150</td>
<td>122699</td>
<td>$1,753.00</td>
<td>Amount of tax on return</td>
</tr>
<tr>
<td>TC610</td>
<td>112199</td>
<td>$953.00</td>
<td>Payment received with the return</td>
</tr>
<tr>
<td>TC660</td>
<td>061798</td>
<td>$800.00</td>
<td>Estimated tax payment</td>
</tr>
</tbody>
</table>

The tax is received seven months and 5 days after the due date of the return. For the purpose of computing the failure to file and failure to pay penalties, this equals eight months. Because both the failure to file and failure to pay penalty apply, the FTF will be computed at .045 for the first five months after the due date of the return.

\[
\begin{align*}
\text{Amount per month} & = \text{Amount} \times \text{Penalty Rate} \\
& = 953.00 \times 0.045 \\
& = 42.89 \\
\text{Failure to file penalty} & = \text{Amount per month} \times \text{Number of months} \\
& = 42.89 \times 5 \\
& = 214.45
\end{align*}
\]
The failure to pay penalty continues to apply for the entire eight months and is computed at one half of one percent (.005).

\[
\begin{align*}
& $ 953.00 \\
& \times .005 \\
& $4.77 \text{ amount per month} \\
& \times 8 \text{ number of months} \\
& $38.16 \text{ failure to pay penalty} \\
& $214.45 \text{ FTF} \\
& + 38.16 \text{ FTP} \\
& $252.62 \text{ total penalty} \\
& $252.61 \text{ total penalty}
\end{align*}
\]

In this example the failure to pay penalty will continue for three months after the failure to file penalty reached the maximum amount.

2. **FRAUDULENT FAILURE TO FILE**

2.10 **Fraudulent Failure to File IRC section 6651(f)**

1. For returns due after December 31, 1989 (determined without regard to extensions), the civil fraud penalty, IRC section 6663, can only apply to situations when a return has been filed. This restriction was legislated in IRC section 6664(b) by OBRA 89.

2. OBRA 89 enacted IRC section 6651(f), Increase in Penalty for Fraudulent Failure to File (FFTF). This penalty generally has an impact equal to the severity of the civil fraud penalty.

3. The burden of proof is on the government to establish FFTF.

2.20 **Penalty Rate**

The FFTF penalty is 15 percent per month of the net amount due for each month the return is delinquent, up to a maximum of five months or 75 percent.

2.30 **Estimated Tax Penalties, Overview**

1. IRC section 6654 provides for a penalty when individuals, estates and most trusts underpay any required installment(s) of estimated income tax liabilities reportable on Forms 1040 (U.S. Individual Income Tax Return) and Forms 1041 (U.S. Fiduciary Income Tax Return).

2. For taxable years beginning before January 1, 1998, taxpayers will not be subject to estimated tax penalties if the tax shown on their return (or, if no return is filed, their tax liability), minus tax amounts withheld from wages during the year, is less than $500. The Taxpayer Relief Act of 1997 increased the $500 threshold to $1,000 for taxable years beginning after December 31, 1997.
2.40 Penalty Rate
Although the estimated tax penalty is not interest, it is computed in the same manner as interest, except it is NOT COMPOUNDED DAILY. Use the debit interest rate in effect for the appropriate time period. A. In accordance with IRC section 6621, the debit interest rate is determined quarterly. This means that the penalty on a $1000 underpayment for one quarterly tax period may be different from the penalty on a $1000 underpayment for a different quarterly tax period. B. Interest rates can be found in the Internal Revenue Bulletin (IRB), News Releases, TAX NEWS, Taxpayer Service Electronic Bulletin Board (TEBB) and Notice 433, Yearly Interest and Certain Penalty Rates.

3. FAILURE TO DEPOSIT

3.10 Failure To Deposit Penalty, Overview And General
1. The Internal Revenue Code (IRC) section 6656 provides for a Failure To Deposit (FTD) Penalty if a taxpayer does not deposit tax in the correct amount, within the prescribed time period, and/or in the required manner.

2. The obligation to deposit employment/excise taxes is ongoing and requires that the taxpayer continues to follow the requirements as long as the taxpayer is incurring these taxes. For example, as long as an employer has employees and is issuing a payroll, that employer must deposit as required.

3.20 Failure-to-Deposit Penalty Rate
The FTD Penalty is charged for any failure to deposit correctly. The three components of a correct deposit are that it is made timely, in the correct amount, and in the correct manner.

1. A failure to comply with any of these components will subject the deposit to an FTD Penalty.

2. Because there may be multiple deposits (with each individual deposit subject to scrutiny for compliance) on any one account, the FTD Penalty that is assessed on the account will be a sum of the "time-sensitive" penalty(ies) and/or the "avoidance" penalty(ies).

3.30 Time Sensitive Portion of the FTD Penalty
For deposits required after December 31, 1989, there is a four tier penalty system. The penalty rate assessed depends on the number of days a deposit is late, as shown below:

1. percent for deposits 1--5 days late,

2. 5 percent for deposits 6--15 days late,

3. 10 percent for all direct payments and those deposits made more than 15 days late, but paid on or before the 10th day following notice and demand.
4. 15 percent (actually, a 5 percent addition to the 10 percent for late payment in (c) above) for all un-deposited taxes still unpaid after the 10th day following the first balance due notice or the day on which notice and demand for immediate payment is given.

3.40 Correction of Cascading Failure to Deposit Penalty
Under prior law, deposits of payroll taxes were allocated to the earliest period for which a deposit was due. If the business makes an insufficient or no deposit, later deposits were first applied to the earlier period and the remainder is applied to the current period. Cascading penalties usually resulted that could have been avoided if later deposits were applied first to the current period. Now businesses can designate the period to which each deposit is applied during the 90-day period beginning on the date of a related IRS penalty notice. Also, the IRS now has the authorization to waive the failure to deposit penalty to the first deposit the business is required to change the frequency of the taxpayers deposits (e.g., from monthly to semi-weekly). (Act '3304; Code '6656; applicable to deposits required to be made more than 180 days after July 22, 1998. A deposit required to be made after December 31, 2001, must be applied to the most recent period or periods within the tax period to which the deposit relates unless the person making the deposit designates otherwise.)

4. REASONABLE CAUSE

4.10 Reasonable Cause
1. Reasonable cause is based on all the facts and circumstances in each situation and allows the IRS to provide relief from a penalty that would otherwise be assessed. Reasonable cause relief is generally granted when the taxpayer exercised ordinary business care and prudence in determining their tax obligations but nevertheless failed to comply with those obligations.

2. In the interest of equitable treatment of the taxpayer and effective tax administration, the non-assertion or abatement of civil penalties based on reasonable cause or other relief provisions provided in this IRM must be made in a consistent manner and should conform with the considerations specified in the IRC, Treasury Regulations (Treas. Regs.), Policy Statements, and IRM Part 20.1, Penalty Handbook.

3. Reasonable cause relief is not available for all penalties; however, other exceptions may apply.

4. For those penalties where reasonable cause can be considered, any reason which establishes that the taxpayer exercised ordinary business care and prudence, but nevertheless was unable to comply with a prescribed duty within the prescribed time, will be considered.
5. If a reasonable cause provision applies only to a specific IRC section, that reasonable cause provision will be discussed in the IRM 20.1 section relating to that specific IRC section. See Exhibit 20.1.1-1, Penalty Relief Application Chart.

6. When considering the information provided in the following subsections, remember that an acceptable explanation is not limited to those given in IRM 20.1. Penalty relief may be warranted based on an "other acceptable explanation," provided the taxpayer exercised ordinary business care and prudence but was nevertheless unable to comply within the prescribed time. See IRM 20.1.1.3.2.2, Ordinary Business Care and Prudence.

7. The wording used to describe reasonable cause provisions varies. Some IRC penalty sections also require evidence that the taxpayer acted in good faith or that the taxpayers failure to comply with the law was not due to willful neglect. See specific IRM 20.1 sections for the rules that apply to a specific IRC penalty section. See IRM 20.1.1.1.2, Organization of IRM 20.1.

8. Taxpayers have reasonable cause when their conduct justifies the non-assertion or abatement of a penalty. Each case must be judged individually based on the facts and circumstances at hand. Consider the following in conjunction with specific criteria identified in the remainder of this subsection:

   A. What happened and when did it happen?
   
   B. During the period of time the taxpayer was non-compliant, what facts and circumstances prevented the taxpayer from filing a return, paying a tax, and/or otherwise complying with the law?
   
   C. How did the facts and circumstances result in the taxpayer not complying?
   
   D. How did the taxpayer handle the remainder of their affairs during this time?
   
   E. Once the facts and circumstances changed, what attempt did the taxpayer make to comply?
   
   F. Reasonable cause does not exist if, after the facts and circumstances that explain the taxpayer’s noncompliant behavior cease to exist, the taxpayer fails to comply with the tax obligation within a reasonable period of time. IRM 20.1.1.3.2 (11-25-2011)

4.20 Standards and Authorities

1. Any reason that establishes a taxpayer exercised ordinary business care and prudence but nevertheless failed to comply with the tax law may be considered for penalty relief.

2. The following Treas. Regs. contain examples of circumstances that may be helpful in determining if a taxpayer has established reasonable cause:
### Table

<table>
<thead>
<tr>
<th>Regulation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Treas. Reg. 1.6664–4</td>
<td>Accuracy-Related Penalties.</td>
</tr>
<tr>
<td>Treas. Reg. 301.6651–1(c)</td>
<td>Failure to File a tax return and/or Failure to Pay tax Penalties</td>
</tr>
<tr>
<td>Treas. Reg. 301.6723–1A(d) and Treas. Reg. 301.6724–1</td>
<td>Information Returns Penalties</td>
</tr>
<tr>
<td>Treas. Reg. 1.6694–2(e)(1)-(6) and Treas. Reg. 301.6707–1T Q&amp;A (4)</td>
<td>Preparer/Promoter Penalties</td>
</tr>
</tbody>
</table>

3. The following Internal Revenue Service policy statements contain specific criteria that may affect the imposition of penalties: IRM 1.2.1, *Servicewide Policies and Authorities - Policies of the Internal Revenue Service*:

4. Policy Statement 2–4, Penalties and interest not asserted against Federal agencies (IRM 1.2.20.1.2)

5. Policy Statement 2–7, Reasonable cause for late filing of return or failure to deposit or pay tax when due (IRM 1.2.12.1.2)

6. Policy Statement 2–9, Timely mailed returns bearing foreign postmarks to be accepted (IRM 1.2.12.1.3)

7. Policy Statement 2–11, Certain unsigned returns will be accepted for processing (IRM 1.2.12.1.5) **IRM 20.1.1.3.2.1 (11-25-2011)**

### 4.30 Ordinary Business Care and Prudence

1. Ordinary business care and prudence includes making provisions for business obligations to be met when reasonably foreseeable events occur. A taxpayer may establish reasonable cause by providing facts and circumstances showing that they exercised ordinary business care and prudence (taking that degree of care that a reasonably prudent person would exercise), but nevertheless were unable to comply with the law.

2. In determining if the taxpayer exercised ordinary business care and prudence, review available information including the following:

   A. **Taxpayer’s Reason:** The taxpayer’s reason should address the penalty imposed. To show reasonable cause, the dates and explanations should clearly correspond with events on which the penalties are based. If the dates and explanations do not correspond to the events on which the penalties are based, request additional information from the taxpayer that may clarify the explanation. See **IRM 20.1.1.3.2, Reasonable Cause**.

   B. **Compliance History:** Check the preceding tax years (at least three) for payment patterns and the taxpayer’s overall compliance history. The same
penalty, previously assessed or abated, may indicate that the taxpayer is not exercising ordinary business care. If this is the taxpayer’s first incident of noncompliant behavior, weigh this factor with other reasons the taxpayer gives for reasonable cause, since a first-time failure to comply does not by itself establish reasonable cause.

C. **Length of Time:** Consider the length of time between the event cited as a reason for the noncompliance and subsequent compliance. See *IRM 20.1.1.3.2, Reasonable Cause*. Consider: (1) when the act was required by law, (2) the period of time during which the taxpayer was unable to comply with the law due to circumstances beyond the taxpayer’s control, and (3) when the taxpayer complied with the law.

D. **Circumstances Beyond the Taxpayer’s Control:** Consider whether or not the taxpayer could have anticipated the event that caused the noncompliance. Reasonable cause is generally established when the taxpayer exercises ordinary business care and prudence, but, due to circumstances beyond the taxpayer’s control, the taxpayer was unable to timely meet the tax obligation. The taxpayer’s obligation to meet the tax law requirements is ongoing. Ordinary business care and prudence requires that the taxpayer continue to attempt to meet the requirements, even though late. *IRM 20.1.1.3.2.2 (02-22-2008)*

### 4.40 Death, Serious Illness, or Unavoidable Absence

1. Death, serious illness, or unavoidable absence of the taxpayer, or a death or serious illness in the taxpayer’s immediate family, may establish reasonable cause for filing, paying, or depositing late for the following:

   A. **Individual:** If there was a death, serious illness, or unavoidable absence of the taxpayer or a death or serious illness in the taxpayer’s immediate family (i.e., spouse, sibling, parents, grandparents, children).

   B. **Corporation, estate, trust, etc.:** If there was a death, serious illness, or other unavoidable absence of the taxpayer (person responsible), or a member of such taxpayer’s immediate family, and that taxpayer had sole authority to execute the return, make the deposit, or pay the tax.

2. If someone other than the taxpayer, or the person responsible, is authorized to meet the obligation, consider the reasons why that person did not meet the obligation when evaluating the request for relief. In the case of a business, if only one person was authorized, determine whether this was in keeping with ordinary business care and prudence.

3. Information to consider when evaluating a request for penalty relief based on reasonable cause due to death, serious illness, or unavoidable absence includes, but is not limited to, the following:

   A. The relationship of the taxpayer to the other parties involved,
B. The date of death,
C. The dates, duration, and severity of illness,
D. The dates and reasons for absence,
E. How the event prevented compliance,
F. If other business obligations were impaired, and
G. If tax duties were attended to promptly when the illness passed, or within a reasonable period of time after a death or return from an unavoidable absence.  IRM 20.1.1.3.2.2.1 (11-25-2011)

4.50 Fire, Casualty, Natural Disaster, or Other Disturbance
1. Determine if the taxpayer could not comply timely because the taxpayer was an "affected person" eligible for disaster relief as provided for in IRM 25.16.1.1, Disaster Assistance and Emergency Relief-Overview. Also see IRM 20.1.1.3.3.6, Official Disaster Area.

2. For taxpayers not considered an "affected person," reasonable cause relief from a penalty may be requested if there was a failure to timely comply with a requirement to file a return or pay a tax as the result of a fire, casualty, natural disaster, or other disturbance. However, one of these circumstances by itself does not necessarily provide penalty relief.

3. Penalty relief may be appropriate if the taxpayer exercised ordinary business care and prudence, but due to circumstances beyond the taxpayer’s control, they were unable to comply with the law.

4. Factors to consider include:
   A. Timing
   B. Effect on the taxpayer’s business
   C. Steps taken to attempt to comply
   D. If the taxpayer complied when it became possible

5. The determination to grant relief from each penalty must be based on the facts and circumstances surrounding each individual case. Determine if the event resulted in a circumstance for which other penalty relief criteria may apply. For example, if the taxpayer was unable to access their records as the result of a fire. See IRM 20.1.1.3.2.2.3, Unable to Obtain Records. If the taxpayer, or responsible party, was unable to comply because he or she was hospitalized as the result of an accident. See IRM 20.1.1.3.2.2.1, Death, Serious Illness, or Unavoidable Absence. IRM @0.1.1.3.2.2.2 (11-25-2011)
4.60 Unable to Obtain Records

1. Explanations relating to the inability to obtain the necessary records may constitute reasonable cause in some instances, but may not in others.

2. Consider the facts and circumstances relevant to each case and evaluate the request for penalty relief.

3. If the taxpayer was unable to obtain records necessary to comply with a tax obligation, the taxpayer may or may not be able to establish reasonable cause. Reasonable cause may be established if the taxpayer exercised ordinary business care and prudence, but due to circumstances beyond the taxpayer’s control, they were unable to comply.

4. Information to consider when evaluating such a request includes, but is not limited to, an explanation as to:
   
   A. Why the records were needed to comply,
   
   B. Why the records were unavailable and what steps were taken to secure the records,
   
   C. When and how the taxpayer became aware that they did not have the necessary records,
   
   D. If other means were explored to secure needed information,
   
   E. Why the taxpayer did not estimate the information,
   
   F. If the taxpayer contacted the IRS for instructions on what to do about missing information,
   
   G. If the taxpayer promptly complied once the missing information was received, and
   
   H. Supporting documentation such as copies of letters written and responses received in an effort to get the needed information. IRM 0.1.1.3.2.2.3 (12-11-2009)

4.70 Mistake was Made

1. The taxpayer may try to establish reasonable cause by claiming that a mistake was made. Generally, this is not in keeping with the ordinary business care and prudence standard and does not provide a basis for reasonable cause.

2. However, the reason for the mistake may be a supporting factor if additional facts and circumstances support the determination that the taxpayer exercised ordinary business care and prudence but nevertheless was unable to comply within the prescribed time.
3. Information to consider when evaluating a request for an abatement or non-assertion of a penalty based on a mistake or a claim of ignorance of the law includes, but is not limited to:

   A. When and how the taxpayer became aware of the mistake,
   B. The extent to which the taxpayer corrected the mistake,
   C. The relationship between the taxpayer and the subordinate (if the taxpayer delegated the duty),
   D. If the taxpayer took timely steps to correct the failure after it was discovered, and
   E. The supporting documentation. **IRM 20.1.1.3.2.2.4** *(12-11-2009)*

4.80 **Erroneous Advice or Reliance**

1. Each request for penalty relief should be reviewed thoroughly to determine the exact basis of the taxpayer's request.

   A. Is the taxpayer claiming they did not comply due to specific advice they received from someone, whether orally or in writing, or
   B. Is the taxpayer claiming they relied on someone else to comply on their behalf?

2. Certain sections of the Internal Revenue Code and Treasury Regulations provide relief from certain penalties based on erroneous advice. See **IRM 20.1.1.3.3.4**, Advice, to first determine if a statutory exception or administrative waiver applies.

3. If the taxpayer states they relied on written or oral advice from the Service but do not qualify for relief in accordance with the criteria in **IRM 20.1.1.3.3.4.1**, Written Advice from the IRS, or **IRM 20.1.1.3.3.4.2**, Oral Advice from the IRS, refer to **IRM 20.1.1.3.2.2**, Ordinary Business Care and Prudence, to determine if the taxpayer exercised ordinary business care and prudence in relying on the Service's advice.

4. The taxpayer may try to establish reasonable cause by claiming they relied on another party to comply on their behalf or that another party provided erroneous advice. Generally, this is not a basis for reasonable cause, particularly for filing or paying obligations, since the taxpayer is responsible for meeting their tax obligations and that responsibility cannot be delegated. However, other factors to consider include:

   A. Was the taxpayer unable to comply because they did not have access to their own records? See **IRM 20.1.1.3.2.2.3**, Unable to Obtain Records.
   B. Was the failure to comply due to a change in the tax law the taxpayer could not reasonably be expected to know? See **IRM 20.1.1.3.2.2.6**, Ignorance of the Law.
5. Consider all facts and circumstances presented by the taxpayer to determine if, despite the exercise of ordinary business care and prudence, the taxpayer nevertheless was unable to comply. IRM 20.1.1.3.2.2.5 (11-25-2011)

4.90 Ignorance of the Law

1. In some instances taxpayers may not be aware of specific obligations to file and/or pay taxes. The ordinary business care and prudence standard requires that taxpayers make reasonable efforts to determine their tax obligations. See IRM 20.1.1.3.2.2, Ordinary Business Care and Prudence.

2. Reasonable cause may be established if the taxpayer shows ignorance of the law in conjunction with other facts and circumstances. For example, consider:
   
   A. The taxpayer's education,
   
   B. If the taxpayer has previously been subject to the tax,
   
   C. If the taxpayer has been penalized before,
   
   D. If there were recent changes in the tax forms or law which a taxpayer could not reasonably be expected to know, and
   
   E. The level of complexity of a tax or compliance issue.

3. Reasonable cause should never be presumed, even in cases where ignorance of the law is claimed.

4. The taxpayer may have reasonable cause for noncompliance due to ignorance of the law if:
   
   A. A reasonable and good faith effort was made to comply with the law, or
   
   B. The taxpayer was unaware of a requirement and could not reasonably be expected to know of the requirement. IRM 20.1.1.3.2.2.6 (11-25-2011)

4.100 Forgetfulness

1. The taxpayer may try to establish reasonable cause by claiming forgetfulness or an oversight by the taxpayer, or another party, caused the noncompliance. Generally, this is not in keeping with the ordinary business care and prudence standard and does not provide a basis for reasonable cause. See IRM 20.1.1.3.2.2, Ordinary Business Care and Prudence.

2. If the taxpayer claims forgetfulness or an oversight by another party, consider the following:
   
   A. Relying on another person to perform a required act is generally not sufficient for establishing reasonable cause.
B. It is the taxpayer’s responsibility to file a timely return and to make timely deposits or payments. This responsibility cannot be delegated. IRM 20.1.1.3.2.2.7 (11-25-2011)

4.110 Statutory Exceptions and Administrative Waivers

This subsection addresses statutory exceptions and administrative waivers. These two very separate categories are placed together because in many instances an administrative waiver is an extension of rules that were provided for by statute. IRM 20.1.1.3.3 (11-25-2011)

4.120 Statutory and Regulatory Exceptions

1. Tax legislation may provide an exception to a penalty. Specific statutory exceptions can be found in either the penalty-related IRC section(s) or the accompanying regulation(s). For example:

<table>
<thead>
<tr>
<th>Legal Reference</th>
<th>Title</th>
<th>IRM Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>IRC 6654(e)(1), (2), or (3)</td>
<td>Estimated Tax Penalties (ES)</td>
<td>IRM 20.1.3</td>
</tr>
<tr>
<td>IRC 7502(a) and IRC 7502(e) (IRC 7502(e)) does not apply to deposits due after Dec. 31, 2010)</td>
<td>Timely Mailing Treated as Timely Filing and Paying</td>
<td>IRM 20.1.2 and IRM 20.1.4</td>
</tr>
<tr>
<td>IRC 6724(a) or IRC 6724(c)</td>
<td>Waiver; Definitions and Special Rules, Information Return Penalties</td>
<td>IRM 20.1.7</td>
</tr>
<tr>
<td>IRC 6404(f)</td>
<td>Abatement of any Penalty or Addition to Tax Attributable to Erroneous Written Advice by the Internal Revenue Service</td>
<td>IRM 20.1.1.3.3.4.1</td>
</tr>
<tr>
<td>IRC 7508</td>
<td>Time for Performing Certain Acts Postponed by Reason of Service in Combat Zone. This provision applies only in a Presidentially declared Combat Zone</td>
<td>IRM 20.1.2.1.2.1, Combat Zone - IRC 7508</td>
</tr>
<tr>
<td>IRC 7508A</td>
<td>Authority to Postpone Certain Deadlines by Reason of Presidentially Declared Disaster or Terroristic or Military Actions</td>
<td>IRM 25.16, Disaster Assistance and Emergency Relief</td>
</tr>
</tbody>
</table>

2. Legislation with retroactive provisions may provide guidance on associated penalties. As a result of that retroactive provision, the IRS may issue a news release or other guidance with instructions for the disposition of the related penalties.
3. IRC 6205 provides for an interest-free adjustment when an employer underreported and underpaid certain employment taxes if specific conditions are met by the employer to report the error and pay the tax due. Prior to Jan. 1, 2009, IRC 6205 and related Treasury Regulations were silent in regard to penalties. Consequently, IRS extended an administrative waiver to certain penalties. See IRM 20.1.1.3.3.2, Administrative Waivers.

4. Effective Jan. 1, 2009, Treas. Reg. 31.6205–1 and Treas. Reg. 31.6302–1 have been amended for interest-free adjustments. When all conditions have been met for an employer to qualify for an interest-free adjustment, the amount timely paid will be deemed to have been timely deposited by the employer. In other words, tax deemed to have been timely deposited is not subject to the failure to deposit (FTD), failure to pay (FTP), and failure to file (FTF) penalties. See IRM 21.7.2.4.6, Adjusted Employer's Federal Tax Return or Claim for Refund, IRM 20.1.2, Failure to File/Failure to Pay Penalties, and IRM 20.1.4, Failure to Deposit Penalty, for required procedures and additional information.

   A. When all regulatory requirements have been met for the amount paid to be considered timely deposited by the employer, penalties should not be assessed.

   B. If penalties were assessed, the account must be carefully reviewed to determine if penalty relief is appropriate, and if so, the correct reason for relief. Did the taxpayer state s/he met all requirements for an interest-free adjustment?
IF
The adjustment was input with TC 290, see IRM 21.7.2.4.6, *Adjusted Employer's Federal Tax Return or Claim for Refund*, to determine if reversal of the TC 290 and reassessment with TC 298 is appropriate,

                     AND
If so, and manual penalty reversal is required (Master File will automatically reverse systemic penalty assessments),

                     THEN
Use Penalty Reason Code (PRC) 044.

If the adjustment was input with TC 298,

                     AND
IRS asserted the penalty(s) incorrectly,

                     THEN
Refer to IRM 20.1.1.3.4, *Correction of Service Error*

If the adjustment was input with TC 298,

                     AND
IRS asserted the penalty(s) correctly,

                     THEN
Explain the reason for the penalty(s) to the taxpayer.

If the adjustment was input with TC 298,

                     AND
The taxpayer did not meet all requirements for an interest-free adjustment,

                     THEN
Use the appropriate PRC for penalty abatement listed in Exhibit 20.1.1-2, *Penalty Reason Code Chart*.

IRM 20.1.1.3.3.1 (11-25-2011)
4.130 Administrative Waivers

1. The IRS may formally interpret or clarify a provision to provide administrative relief from a penalty that would otherwise be assessed. An administrative waiver may be addressed in either a policy statement, news release, or other formal communication stating that the policy of the IRS is to provide relief from a penalty under specific conditions.

   Example:
   An example of an administrative waiver is Notice 98-30, IRB 1998-22. This allowed a temporary waiver of the failure to deposit penalty for certain taxpayers first required to make federal tax deposits by EFTPS beginning on or after July 1, 1997.

2. An administrative waiver may be necessary when there is a delay by the IRS in:
   A. Printing or mailing of forms,
   B. Publishing guidance (e.g. writing of Regulations), or
   C. Other conditions.

3. IRC 6205 permits adjustments to be made, without interest, to correct underpayments of employment taxes. The amount of the underpayment must be paid by the time an adjusted return (e.g., Form 941–X, Adjusted Employer’s QUARTERLY Federal Tax Return or Claim for Refund) is filed or interest will begin to accrue from that date.
   A. The regulations under IRC 6205 provide that an interest-free adjustment cannot be made if the failure to report relates to an issue that was raised in an examination of a prior return period or if the employer knowingly underreported its employment tax liability.
   B. Also, under the regulations, an interest-free adjustment cannot be made after receipt of notice and demand for payment or after receipt of a Notice of Determination of Worker Classification.

4. For errors discovered on or after January 1, 2009, Treas. Reg. 31.6302-1 provides that an amount timely paid with an adjusted return under Treas. Reg. 31.6205-1 will be deemed to have been timely deposited by the employer. See IRM 20.1.1.3.3.1, Statutory and Regulatory Exceptions, for penalty information related to interest-free adjustments for employment taxes for errors discovered on or after Jan. 1, 2009.

5. For errors discovered prior to Jan. 1, 2009, take the following action to meet the IRS’s responsibility to provide fair and consistent treatment to taxpayers:
A. For an increase of tax that qualifies for an interest-free adjustment, the IRS will not assess failure to file (TC 16X), failure to pay (TC 27X) or failure to deposit (TC 18X) penalties; provided the tax increase is paid by the due date of the tax period in which additional tax was ascertained.

Note:
If there’s a previously assessed TC 16X, on the tax period, it may be necessary to restrict the failure to file penalty by entering a TC 160 .00 on the adjustment.

B. The tax adjustment will be represented by a TC 298/308, with an interest computation date.

C. If one of the previously identified penalties has been assessed and a request for abatement is received, the abatement will be done as an Administrative Waiver if the penalty is based on the TC 298/308 tax increase (provided the tax increase was paid by the due date of the tax period in which it was ascertained). IRM 20.1.1.3.3.2 (11-25-2011)

4.140 Undue Hardship

1. An undue hardship may support the granting of an extension of time for paying a tax or deficiency (Form 1127, Application for Extension of Time for Payment of Tax). Treas. Reg. 1.6161–1(b), provides that an undue hardship must be more than an inconvenience to the taxpayer. The taxpayer must show that they would sustain a substantial financial loss if required to pay a tax or deficiency on the due date.

A. Undue hardship generally does not affect a person’s ability to file and therefore would not provide a basis for penalty relief in a failure to file situation. However, each request must be considered on a case-by-case basis.


2. The extension of time to pay does not provide the taxpayer with an extension of time to file. Nor does the extension of time to pay relieve the taxpayer of any appropriate penalties (see IRM 20.1.2.1.3.2), Extensions of Time to Pay - IRC 6161.

3. Undue hardship may also support relief from the addition to tax for failure to pay tax if the explanation for the noncompliance supports such a determination. However, the mere inability to pay does not ordinarily provide the basis for granting penalty relief. Under Treas. Reg. 301.6651–1(c), the taxpayer must also show that they exercised ordinary business care and prudence in providing for the payment of the tax liability.
A. The taxpayer may claim that enough funds were on hand, but as a result of unanticipated events, the taxpayer was unable to pay the taxes.

B. Consider an individual taxpayer’s inability to pay a factor when considering penalty relief if the taxpayer shows that, had the payment been made on the payment due date, undue hardship (as defined in Treas. Reg. 1.6161–1(b)) would have resulted.

C. In the case where a taxpayer files bankruptcy, consider inability to pay a factor if the insolvency occurred before the tax payment due date.

4. If payroll was met, taxes were withheld and should be available for deposit. Employers must reserve money withheld from employees’ wages in trust until deposited. The employer should not use the money for any other purpose. Undue hardship does not support relief from the penalty under IRC 6672, Failure to Collect and Pay Over Tax, or Attempt to Evade or Defeat Tax (Trust Fund Recovery Program).

5. Information to consider when evaluating a request for penalty relief includes, but is not limited to, the following:
   A. When did the taxpayer know they could not pay?
   B. Why was the taxpayer unable to pay?
   C. Did the taxpayer explore other means to secure the necessary funds?
   D. What did the taxpayer supply in the way of supporting documentation, such as copies of bank statements?
   E. Did the taxpayer pay when the funds became available? IRM 20.1.1.3.3.3 (12-11-2009)

4.150 Advice
   1. This section discusses the three basic types of advice that may qualify for Statutory, Regulatory, or Administrative penalty relief:
      A. Written advice provided by IRS
      B. Oral advice provided by IRS
      C. Advice provided by a tax professional

   2. Information to consider when evaluating a request for abatement or non-assertion of a penalty due to reliance on advice includes, but is not limited to, the following:
      A. Was the advice in response to a specific request and was the advice received related to the facts contained in that request?
      B. Did the taxpayer reasonably rely on the advice?
3. The following instances address some situations where penalty relief may not be appropriate even though the taxpayer relied on written advice from the IRS regarding an item on a filed return:

   A. The taxpayer did not reasonably rely on the advice regarding an item included on a return if the advice was received after the date the return was filed;

      **Note:** A taxpayer may be considered to have reasonably relied on advice received after the return was filed if they then filed an amended return that conformed with such written advice.

   B. A taxpayer may not be considered to have reasonably relied on written advice unrelated to an item included on a return, such as advice on the payment of estimated taxes, if the advice is received after the estimated tax payment was due.

   C. Did the taxpayer, or their authorized representative, provide the IRS or the tax professional with adequate and accurate information? The taxpayer is entitled to penalty relief for the period during which they relied on the advice. The period continues until the taxpayer is placed on notice that the advice is no longer correct or no longer represents the Service’s position.

4. The taxpayer is placed on notice as the result of any of the following events that present a contrary position and occur after the issuance of the written advice:

   A. Written correspondence from the IRS that its advice is no longer correct or no longer represents the IRS’s position,

   B. Enactment of legislation or ratification of a tax treaty,

   C. A U.S. Supreme Court decision,

   D. The issuance of temporary or final regulations, or

   E. The publication of a revenue ruling, revenue procedure, or other statement in the Internal Revenue Bulletin.

5. Generally, Form 843, Claim for Refund and Request for Abatement, is required to be filed to request penalty abatement based on erroneous written advice by the IRS. However, if Form 843 is not filed and the information provided demonstrates that abatement of the penalty is warranted, the penalty should be abated, whether or not a Form 843 is provided. Information required to be provided includes:

   A. The taxpayer’s written request for advice,

   B. The erroneous written advice furnished by the Service to the taxpayer and relied on by the taxpayer, and
C. The report (if any) of tax adjustments that identifies the penalty or addition to tax and the item relating to the erroneous written advice. **IRM 20.1.1.3.3.4 (12-11-2009)**

### 4.160 Written Advice from the IRS

1. The IRS is required by IRC 6404(f) and Treas. Reg. 301.6404–3 to abate any portion of any penalty attributable to erroneous written advice furnished by an officer or employee of the IRS acting in their official capacity.

2. If the taxpayer does not meet the criteria for penalty relief under IRC 6404(f), the taxpayer may qualify for other penalty relief. For instance, taxpayers who fail to meet all of the IRC 6404(f) criteria may still qualify for relief under reasonable cause if the IRS determines that the taxpayer exercised ordinary business care and prudence in relying on the IRS’s written advice. **IRM 20.1.1.3.2.2.5 - Erroneous Advice or Reliance.**

3. Requests that qualify for penalty relief based on erroneous written advice from the IRS under IRC 6404(f) must be filed:
   - A. Within the period allowed for collection of the penalty or addition to tax, or
   - B. If the penalty or addition to tax has been paid, within the period allowed for claiming a credit or refund of such penalty or addition to tax. **IRM 20.1.1.3.3.4.1 (11-25-2011)**

### 4.170 Oral Advice from IRS

1. The IRS may provide penalty relief based on a taxpayer’s reliance on erroneous oral advice from the IRS. The IRS is required by IRC 6404(f) and Treas. Reg. 301.6404–3 to abate any portion of any penalty attributable to erroneous written advice furnished by an employee acting in their official capacity. Administratively, the IRS has extended this relief to include erroneous oral advice when appropriate.

2. In addition to considering the criteria provided in Treas. Reg. 301.6404–3, **IRM 20.1.1.3.3.4, Advice, and IRM 20.1.1.3.3.4.1, Written Advice From the IRS**, consider the following:
   - A. Did the taxpayer exercise ordinary business care and prudence in relying on that advice?
   - B. Was there a clear relationship between the taxpayer’s situation, the advice provided, and the penalty assessed?
   - C. What is the taxpayer’s prior tax history and prior experience with the tax requirements?
   - D. Did the IRS provide correct information by other means (such as tax forms and publications)?
   - E. What type of supporting documentation is available?
3. The following is supporting documentation:

   A. A notation of the taxpayer’s question to the IRS,
   B. Documentation regarding the advice provided by the IRS,
   C. Information regarding the office and method by which the advice was obtained,
   D. The date the advice was provided, and
   E. The name of the employee who provided the information. IRM 20.1.1.3.3.4.2 (12-11-2009)

4.180 Advice from a Tax Advisor

   1. Reliance on the advice of a tax advisor generally relates to the reasonable cause exception in IRC 6664(c) for the accuracy-related penalty under IRC 6662. See IRM 20.1.5, Return Related Penalties, and Treas. Reg. 1.6664–4(c).

   2. However, in very limited instances, reliance on the advice of a tax advisor may provide relief from other penalties when the tax advisor provides advice on a substantive tax issue.

   Example:

   The employer researched all available IRS publications on the subject of contract labor, provided clear and convincing documentation as to the duties of the workers to the tax advisor, and requested an opinion from the tax advisor as to whether the workers were "contract labor" or "employees." As a result, the tax advisor advised the employer that the workers were "contract labor." However, the IRS later determined that the workers were "employees" and not "contract labor."

   3. Penalty relief based on reliance on the advice of a tax advisor is limited to issues generally considered technical or complicated. The taxpayer’s responsibility to file, pay, or deposit taxes cannot be excused by reliance on the advice of a tax advisor.

   4. Because the IRC and Treasury Regulations sections that provide penalty relief criteria for erroneous advice from a tax advisor are generally limited to the accuracy-related penalty, relief from other penalties must meet the reasonable cause standards. See IRM 20.1.1.3.2, Reasonable Cause. IRM 20.1.1.3.3.4.3 (12-11-2009)

4.190 Fire, Casualty, Natural Disaster, or Other Disturbance

   1. This section discusses penalty relief provisions for circumstances that generally fall under the definition of "major disaster " (such as a hurricane, tornado, earthquake, etc.) or "emergency" (see IRM 25.16.1.1) and that affect a significant number of taxpayers located within a designated geographical area.
2. Generally, relief is provided in the form of extensions of time to file or pay and is usually provided systemically with the setting of an "O" Freeze or "S" Freeze posted to the account (see IRM 25.16.1.3.2, Disaster Assistance and Emergency Relief, "O" Freeze, and IRM 25.16.1.3.3, Disaster Assistance and Emergency Relief, "S" Freeze).

3. The determination to grant relief from each penalty must be based on the facts and circumstances surrounding each individual case.

4. For additional guidelines, including guidelines for reasonable cause consideration where systemic penalty relief is not applicable, see IRM 20.1.1.3.2.2.2 IRM 20.1.1.3.3.5 (11-25-2011)

4.200 Official Disaster Area

1. When a significant disaster occurs affecting a wide area of taxpayers, the IRS often issues special instructions to facilitate evaluating the request for penalty relief.

2. Because these are one-time instructions, they will not be incorporated in this IRM. Territories, Campuses, and Customer Service sites will be kept informed of any special instructions affecting their areas. IRM 20.1.1.3.3.6 (11-25-2011)

4.210 Correction of Service Error

1. An IRS error can be any error made by the IRS in computing or assessing tax, crediting accounts, etc.

2. Other Service Error examples are:

   A. A math error when manually computing a penalty,

   B. An extension of time to file that did not post to the Master File (and manual input of a TC 460 did not, or will not, result in an automatic penalty reversal, if input of a TC 460 is appropriate in accordance with IRM 20.1.2.1.3.1.1, Extension of Time to File Not Found, or

   C. Any other error, when it can be shown that; (1) the taxpayer did in fact comply with the law, and (2) the IRS did not initially recognize that fact. IRM 20.1.1.3.4 (11-25-2011)

4.220 Reasonable Cause Assistant (RCA)

1. The Reasonable Cause Assistant (RCA) will be used when considering penalty relief due to reasonable cause. RCA is to be used after normal case research has been performed, (i.e., applying missing deposits/payments, adjusting tax, or researching for missing extensions of time to file, etc.) for the following penalties:

   A. IMF - failure to file (FTF) and failure to pay (FTP)

   B. BMF - failure to deposit (FTD) (currently limited to MFTs 01, 10, 11, 14, and 16)
2. RCA is a decision-support interactive software program developed to reach a reasonable cause determination. RCA is accessed through the AMS (Account Management Services) Tools menu.

3. Use of RCA will ensure consistent and equitable administration of penalty relief consideration.

4. When an employee has determined that a taxpayer has requested penalty relief based on Reasonable Cause, whether the request was made by telephone or in writing, RCA will be accessed to determine if penalty relief will be granted.

Caution:

See IRM 20.1.1.3.5 to determine if penalty relief can be considered, or if penalty relief can only be considered by another function. IRM 20.1.1.3.6 (11-25-2011)

4.230 First Time Abate (FTA)

1. RCA provides an option for penalty relief for the FTF, FTP, and/or FTD penalties if the taxpayer has not previously been required to file a return or if no prior penalties (except the Estimated Tax Penalty, TC 17X) have been assessed on the same MFT (except MFT 30/31, and see the exception for MFTs 01 and 14 in paragraph (3)(f)) in the prior 3 years. This First-time Abate (FTA) aspect is an Administrative Waiver and does not carry any Oral Statement Authority (OSA) dollar threshold. See IRM 20.1.1.3.6.3 for additional OSA information. Also, FTA carries its own PRCs - 018 for non-RCA/manual look-back, or 020 for RCA being used to make the determination. See IRM 20.1.1.3.6.2

2. Notwithstanding the exception in paragraph (5)(c) of this section, a penalty assessed and subsequently reversed in full will generally be considered to show compliance for that tax period. RCA considers fully reversed penalties in its FTA analysis.

3. The FTA Administrative Waiver can only apply to a single tax period for a given MFT. For example, if a request for penalty relief is being considered for 2 or more tax periods on the same MFT and the earliest tax period meets FTA criteria, penalty relief based on FTA only applies to the earliest tax period, not all tax periods being considered. Penalty relief for all subsequent tax periods will be based on the showing of reasonable cause (and absence of willful neglect).

4. The reasonable cause explanation provided by the taxpayer will be considered after RCA performs the First-time Abate/Clean Compliance History analysis. If FTA criteria does not apply based on reasons shown in (3) below, then the taxpayer’s explanation will be used to determine if reasonable cause penalty relief criteria is met. If the RCA determination is to abate the penalty(s), penalty relief can be granted as appropriate per the RCA conclusion (i.e., Reasonable Cause, Official Disaster Relief area, IRS Error, Statutory and Administrative Waivers). Using the First-time Abate/Clean Compliance History analysis up front was based on a request from HQ Customer Accounts Services.
5. A First Time Abate conclusion **WILL NOT** apply if any of the following criteria applies:

A. Any tax period in the prior 3 years, for the same MFT (except MFT 30/31, and see the exception for MFTs 01 and 14 in paragraph (3)(f)), is in TDI Status 02 or 03, or IMF Status 04.

B. An unreversed penalty for a significant amount (see *Caution* for an explanation of significant amount) is present (except the ES penalty) on any tax period in the prior 3 years, for the same MFT (except MFT 30/31, and see the exception for MFTs 01 and 14 in paragraph (3)(f)), and a notice was issued showing the assessed penalty(s).

**Caution:**

**Note:**

A module balance cleared with a TC 606 indicates a notice showing the assessed penalty(s) **was not** issued.

C. Any penalty reversal or penalty suppression on any tax period in the prior 3 years for the same MFT (except MFT 30/31, and see the exception for MFTs 01 and 14 in paragraph (3)(f)) was input with Penalty Reason Code (PRC) 018, 020, or 021. See Exhibit 20.1.1-2, Penalty Reason Code Chart.

**Additional criteria specific to BMF accounts is as follows:**

D. The FTD penalty is charged for EFTPS Avoidance. Taxpayers required by law to deposit using EFTPS have received multiple notifications from the Treasury Financial Agent (TFA) and the Electronic Tax Administration (ETA) prior to their required EFTPS start date. Use RCA for normal penalty relief consideration.

**Note:**

Beginning Jan. 1, 2011, all required deposits must be made by EFTPS, and the TFA/ETA notifications were discontinued. However, this criterion will continue to apply.

E. A total of four or more FTD Penalty Waiver Codes are present in the taxpayer's three-year penalty history for the same MFT (see the exception for MFTs 01 and 14 in paragraph (3)(f)). Waiver Code 24 is set when the FTD penalty is waived due to a change in deposit frequency. Waiver Code 25 is set when the FTD penalty is waived per IRM 20.1.4.3, Restrictions on Assessments criteria. When a Waiver Code applies, the applicable Waiver Code will be shown with the literal "FTD PEN WAIVER CD" on CC BMFOL definer "R." RCA will check the taxpayer's three-year history for the presence of four or more Waiver Codes.
F. The three-year penalty history for either MFT 01 (Form 941, Employer's Quarterly Federal Tax Return,) or MFT 14 (Form 944, Employer's Annual Federal Tax Return,) must include a review of both MFT 01 AND MFT 14 accounts.

Example:

Taxpayer A files Form 944 for tax year 2010 and is assessed a FTD penalty (TC 186) on the MFT 14 account. For all years prior to tax year 2010, the taxpayer filed Form 941. The MFT 01 account for the 2nd quarter of 2009 (200906) has unreversed FTD, FTF, and FTP penalties; therefore, the taxpayer does not qualify for FTA relief on the MFT 14 account for 2010 (201012).

6. When checking the three-year penalty history, RCA does not recognize any module(s) that has moved to the retention register. This should not be a problem when using RCA on current tax periods; however, when using RCA for an older tax period, the employee must manually review any tax period(s) in the three-year penalty history that has gone to the retention register.

7. If RCA determines a First-Time Abate is applicable, correspondex letters 3502C for BMF FTD penalty relief, or 3503C for IMF FTF and/or FTP penalty relief can be generated through RCA and IDRS. Both letters contain a paragraph automatically selected by RCA informing the taxpayer that the penalty(s) was removed based on their history of compliance. The following is an example of this paragraph:

We are pleased to inform you that your request to remove the (use applicable penalty, i.e. failure to file, failure to pay, or failure to deposit) penalty(s) has been granted. However, this action has been taken based solely on your compliance history rather than on the information you provided. This type of penalty removal is a one-time consideration available only for a first-time penalty charge. IRS will base decisions on removing any future (failure to file, failure to pay, failure to deposit) penalties on any information you provide that meets reasonable cause criteria. You should receive a notice of penalty adjustment within the next few weeks.

Note:

Include an explanation that educates the taxpayer how to be compliant in the future.

8. First-time abatement may be considered for FTF and/or FTP on all forms (see Exception, following Note, below). The employee must check the three prior years and document the clean compliance history. If RCA is not used to consider first-time relief and relief is granted, use PRC 018 when making the adjustment. Notify the taxpayer that the penalty removal was based on their history of compliance rather than on the information they provided (see example paragraph above). Also include an explanation that educates the taxpayer about how to be compliant in the future.

Note:
If RCA does not offer FTA relief because the FTD penalty was charged for EFTPS Avoidance, FTA relief can still be granted for the FTF and/or FTP penalties, if applicable.

**Exception:**

Penalty relief under the FTA provision does not apply to returns with an event-based filing requirement, such as Form 706, *U.S. Estate Tax Return*, and Form 709, *United States Gift (and Generation - Skipping Transfer) Tax Return*; the Daily Delinquency Penalty (DDP); Form 1120, *U.S. Corporation Income Tax Return*/Form 1120S, *U.S. Income Tax Return for an S Corporation* if, in the prior 3 years, at least 1 Form 1120S was filed late but not penalized. This list is not all-inclusive.

9. If the tax is not paid in full on the tax period when the request for abatement is received, allow first-time abate/clean compliance history on the failure to pay (FTP) penalty amount assessed. Use RC 062 with the TC 271 and PRC 018 or 020. This will allow the FTP penalty to start up when the TC 271 posts to Master File on the remaining tax due. While the first-time abatement is due to an administrative waiver, not reasonable cause, the RC 062 will not restrict the tax period and is to be used in this instance only. The proper use of the PRC will allow for the tracking of first-time/compliance history abatements.

**Note:**

The employee will need to use the open paragraph in the 3502C or 3503C letter to inform the taxpayer that the FTP penalty will start accruing again on the unpaid taxes and will continue until the tax is paid in full. After the tax is paid in full, the taxpayer may request reasonable cause abatement of the additional FTP penalty.

10. If the tax is fully paid, the First-time Abate/Clean Compliance History adjustment to the FTP (TC 271) may be done using RC 065 (IMF Accounts) with PRC 018 or 020 as the restrictive action will not have a negative effect. Adjustment notices will be sent in both abatement instances.

11. RCA will also display a First-time Abate window on a BMF account when the taxpayer has a change in deposit frequency. Employees need to be aware this is different than a First-time Abate for a good compliance history and use the appropriate PRC when removing the penalty for a first-time change in deposit frequency. IRM 20.1.1.3.6.1 (11-25-2011)

5. **ACCURACY PENALTIES**

5.10 **OBRA 89 Consolidated And Renumbered The Following Penalty Code Sections:**

1. The accuracy-related penalty rate is 20 percent of the underpayment attributable to
any adjustments on the above. The penalty increases to 40 percent when there is a
gross valuation misstatement as defined in IRC section 6662(h).

2. OBRA 89 changed the civil fraud penalty from IRC section 6653(b) to 6663. The
penalty rate is 75 percent of the underpayment attributable to fraud.

3. OBRA 89 added IRC section 6664 to provide definitions and special rules that apply
to both the accuracy-related penalties and the civil fraud penalty.

5.20 Common Features: Accuracy-Related and Civil Fraud Penalties

1. All accuracy-related and civil fraud penalties are associated with the examination of
a tax return. See Treas. Reg. 1.6662-2(a). Penalty review, abatement, and
reconsideration follow guidelines established for the examination of the return.

2. Return Filing Requirement: The accuracy-related penalty and the civil fraud penalty
apply when a return has been filed, either timely or late. The accuracy-related
penalties under IRC section 6662 and the civil fraud penalty under IRC section 6663
cannot be asserted on a substitute-for-return filed under IRC section 6020(b). See
IRC section 6664(b).

3. Uniform Definition of Underpayment: IRC section 6664(a) provides a common
definition of underpayment. The accuracy-related and civil fraud penalties are
calculated only on the underpayment (or portion of the underpayment) of tax
attributable to the misconduct or fraud, as applicable. See IRC sections 6662(a) and
6663(a).

4. Coordination of Accuracy-Related and Civil Fraud Penalties: The accuracy-related
and civil fraud penalties cannot be asserted on the same portion of the same
underpayment. However, the accuracy-related penalty and the civil fraud penalty
may be asserted on the same return when civil fraud applies to one portion of the
underpayment and the accuracy-related penalty applies to another portion of the
underpayment. See IRC section 6662(b).

5.30 Negligence or Disregard of Rules and Regulations

OBRA 89 redesignated the negligence penalty from IRC section 6653(a) to). IRC section
6662(b)(1) applies to returns due after December 31, 1989 (without regard to extensions).
2.6662(b)(1) creates a negligence penalty of 20 percent of the underpayment attributable to
negligence or disregard of rules or regulations.

5.40 Negligence Penalty Assertion

1. Negligence includes any failure to make a reasonable attempt to comply with the
provisions of the tax law, exercise ordinary and reasonable care in tax return
preparation, or keep adequate books and records. (See Treas. Reg. 1.6662-3(b).)
2. The regulations also provide that negligence is strongly indicated when a taxpayer fails to report income shown on an information return, fails to make a reasonable inquiry into the correctness of a deduction, credit, or exclusion on a tax return that seems "too good to be true," or when the returns of partners or S corporation shareholders are clearly inconsistent with the tax returns of their respective entities.

3. Some indications of negligence follow:

   A. Unreported or understated income,
   B. Deductions or credits significantly overstated,
   C. Careless, improper, or exaggerated deductions,
   D. Misrepresenting or mis-categorizing deductions in such a manner as to conceal the true nature of the deduction,
   E. Unexplainable items,
   F. Inadequate books and records,
   G. Cooperative state programs and state reports showing a negligence penalty (taking into account other factors and not relying entirely on the findings of another taxing agency),
   H. Substantial errors on an issue that had been adjusted in a prior year,
   I. Giving the preparer incorrect or incomplete information to prepare the returns.

5.50 Penalty Relief

1. Reasonable Cause. The penalty does not apply if the taxpayer has reasonable cause and acted in good faith, i.e., if an error was due to an honest misunderstanding of the facts or the law and the taxpayer took reasonable steps to comply with the law.

2. Adequate Disclosure. Disclosure is adequate if: A. It is made with the return, or on a qualified amended return, and B. Unless otherwise prescribed by the Commissioner, a completed Form 8275, Disclosure Statement, is filed with the original return or qualified amended return. Form 8275-R, Regulations Disclosure Statement, is necessary for disclosing a position contrary to a regulation. C. Treas. Regs. 1.6662-3(c), 1.6662-4(e) and (f) define adequate methods of disclosure for returns due after December 31, 1991, the effective date of the regulations. D.

3. When disclosure is not adequate. The exception for adequate disclosure will not apply if: A. The item on the return is attributable to a tax shelter, B. The taxpayer has not kept adequate books and records, or fails to substantiate items on the return, C. For returns due (without regard to extension) before January 1, 1994, the item or position on the return is frivolous (i.e., patently improper), or D. For returns due (without regard to extension) after December 31, 1993, the item or position on the return does not have a reasonable basis. (Applies to disregard of rules and regulations only.)
4. Adequate Disclosure Determination. The applicability of the disclosure exception is determined for each item or group of similar items separately. When the adequate disclosure exception is met (except in the case of a tax shelter), the tax attributable to the disclosed item is not included in the calculation of the underpayment for penalty purposes.

5. Negligence and Adequate Disclosure: A. For returns due after December 31, 1989 and before January 1, 1994 the adequate disclosure exception does not apply if the item is frivolous. See Notice 90-20, 1990-1 C.B. 328. B. For returns due after December 31, 1993, adequate disclosure does not apply. Whenever the taxpayer has a reasonable basis for an item or position taken, negligence by definition does not apply.

6. Disregard of Rules or Regulations and Adequate Disclosure: A. Adequate disclosure is an exception to the penalty attributable to disregard of rules or regulations. Since the penalty attributable to negligence (for returns due after December 31, 1993) is not subject to a disclosure exception, the distinction between negligence and disregard of rules and regulations will sometimes have to be made. B. The penalties attributable to negligence and disregard of rules or regulations often overlap, seem to apply equally to any given case, and are often difficult to distinguish. (See Treas. Reg. 1.6662-3(b)(1) and (2) for the definitions of negligence and disregard.) C. For returns due after December 31, 1991 (without regard to extensions) and before January 1, 1994, the disclosure exception is met for disregard of rules or regulations only when the required form is filed by the taxpayer (Form 8275 or 8275-R), and the item or position on the return has a realistic possibility of being sustained on its merits. D. For returns due after December 31, 1993 (without regard to extensions), the disclosure exception is available if the position taken on the return has a reasonable basis. E. The penalty for disregard usually applies if an item on the return is contrary to the Internal Revenue Code, temporary or final regulations issued under the Internal Revenue Code, or a revenue ruling or notice (other than notices of proposed rule making) published in the Internal Revenue Bulletin. However, the penalty does not apply to a position contrary to a revenue ruling or notice if the item has a realistic possibility of being sustained on its merits.

5.60 IRC Section 6662(d): Substantial Understatement

1. OBRA 89 repealed IRC section 6661, Substantial Understatement of Liability, and replaced it with the accuracy-related penalties in IRC section 6662(d).

2. The penalty is 20 percent of the underpayment of income tax when there is a substantial understatement of income tax. An understatement is substantial when it exceeds the greater of 10 percent of the tax required to be shown on the return for a taxable year, or $5,000 ($10,000 for C-corporations).
5.70 **Substantial Authority Exception**

1. The penalty under IRC section 6662(d) will not be asserted if there is substantial authority for the tax treatment of an item or return position. When the taxpayer's authority for the item or return position is substantial with respect to the authority against it, the penalty will not be asserted. Authorities relevant to both sides of the tax treatment of an item are taken into account.

2. Substantial authority is an objective standard involving an analysis and application of the law to the relevant facts. It is not determined with reference to what the taxpayer actually believed to be the correct treatment of the item. Every item must be separately evaluated to determine whether there is substantial authority for the tax treatment of an item.

   A. The substantial authority standard is less rigid than the "more likely than not" standard. The "more likely than not" standard is met when there is more than a 50 percent likelihood that the position would be sustained.

   B. The substantial authority standard is more rigid than the reasonable basis standard. The reasonable basis standard has not been defined by regulation, but per the committee reports associated with section 13251 of the Uruguay Round Agreement Act, P.L. 103-465 dated December 8, 1994, is the same standard that precludes the assertion of the penalty for negligence and disregard of rules and regulations. A position having a reasonable basis is a position that is arguable but fairly unlikely to prevail in court.

   C. Therefore, the substantial authority exception can be met when the taxpayer has less than a 50 percent, but more than a one-in-three likelihood of being sustained on the issue.

3. "Authority" under Treas. Reg. 1.6662-4(d)(3)(iii) is established by reference to:

   A. The Internal Revenue Code and other statutory provisions;

   B. Proposed, temporary and final regulations;

   C. Revenue rulings and revenue procedures;

   D. Tax treaties, the regulations thereunder, and Treasury Department and other official explanations of such treaties;

   E. Court cases;

   F. Congressional intent as reflected in committee reports, joint explanatory statements of managers included in conference committee reports, and floor statement made prior to enactment by one of a bill's managers;
G. General Explanations of tax legislation prepared by the Joint Committee on Taxation (the "Blue Book");

H. Private letter rulings and technical advice memoranda issued after October 31, 1976;

I. Actions on decisions and general counsel memoranda issued after March 12, 1981 (as well as general counsel memoranda published in pre-1955 volumes of the Cumulative Bulletin);

J. IRS information releases and press releases;

K. Notices, announcements and other administrative pronouncements published by the Service in the Internal Revenue Bulletin.

4. Taxpayers automatically meet the substantial authority standard if:

A. They have been named in a technical advice memorandum,

B. Have been issued a district director’s determination letter,

C. Have been issued a private letter ruling, or

D. Received a revenue agent’s report for a prior taxable year with an affirmative statement on the same item.

E. Taxpayers do not automatically meet the substantial authority standard if a private letter ruling is revoked or is inconsistent with:

(1) Subsequent proposed regulations

(2) Subsequent revenue rulings, or

(3) Other administrative pronouncements published in the Internal Revenue Bulletin.


(5) The term "authority" does not include treatises, legal periodicals, legal opinions or opinions rendered by other tax professionals.

(6) An authority does not continue to be an authority if it is overruled or modified, implicitly or explicitly, by a body having the power to overrule or modify an earlier authority such as a U.S. Court of Appeals overruling a district court which originally issued the authority used by the taxpayer.
(7) A Tax Court opinion is not considered to be overruled or modified by a court of appeals to which a taxpayer does not have a right of appeal, unless the Tax Court adopts the holding of the court of appeals.

(8) Substantial authority is determined as of the date of filing or the last day of the taxable year. (See Treas. Reg. 1.6662-4(d)(3)(iv)(C).)

(9) For determining the weight of various "authorities" see Treas. Regs. 1.6662-4(d)(3)(ii).

5.80 Adequate Disclosure Exception

1. When the adequate disclosure exception is met, the tax attributable to the disclose item or return position is not included in the calculation of the understatement for penalty purposes.

2. Generally, the accuracy-related penalty attributable to substantial understatement will not be asserted on the underpayment attributable to an item that is adequately disclosed. However, even when the item is adequately disclosed the penalty will still be asserted if:
   
   A. For returns due after January 31, 1991, but before January 1, 1994--the disclosed item is frivolous, i.e., patently improper (see former Treas. Regs. 1.6662-3(b)(3)),
   
   B. For returns due after December 31, 1993--the disclosed item does not meet the reasonable basis standard,
   
   C. The taxpayer failed to keep adequate books and records or failed to substantiate the disclosed item. (IRM 4271, Inadequate Records Cases), or
   
   D. The item is attributable to a tax shelter as defined in IRC section 6662(d)(2)(C)(iii) and Treas. Reg. 1.6662-4(g)(2).

3. Disclosure is adequate if it is made in a statement attached to a return, i.e., Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement. A. Disclosure is considered adequate for tax return line item entries identified in and disclosed according to the annual revenue procedure that applies for the year of the return. B. If the revenue procedure does not expressly provide that disclosure of an item on the return is sufficient, disclosure should be made on Form 8275.

4. The definition of adequate disclosure provided by the following revenue procedures only pertains to the accuracy-related penalty attributable to a substantial understatement.
6. HISTORY AND REQUIREMENTS

6.10 History And Requirements Of Abatement Of Interest Claims
IRC 6404(e)(1) was added by the Tax Reform Act of 1986 to provide for abatement of interest on deficiencies or payments attributable to errors or delays in the performance of ministerial acts by the Service. A ministerial act is a procedural, mechanical, processing-type act that does not involve the exercise of judgment, and that occurs after all prerequisites to the act have taken place. See Revenue Procedure 87-42 and regulation section 301.6404-2T for additional guidance.

6.20 IRC Section 6404(e)(1)
As originally enacted, IRC Section 6404(e)(1) allows the Service to abate interest when an IRS employee fails to perform a ministerial act in a timely manner or makes an error in the performance of that act. Interest attributable to the delay may be abated provided no significant aspect of the delay is attributable to the taxpayer. Only delays in the performance of a ministerial act that would be "widely perceived as grossly unfair" (Committee Reports) will merit abatement. (For purposes of this provision, Chief Counsel employees will be treated as employees of the IRS.)

6.30 Taxpayer Bill of Rights 2
On July 30, 1996, the Taxpayer Bill of Rights 2, was enacted amending IRC section 6404(e)(1) to add "unreasonable" before each reference to "error" in the statute and to replace each reference to performing a "ministerial act" with a reference to performing a "ministerial or managerial act." P.L. 104-168, 110 Stat. 1452. These changes to IRC section 6404(e) are effective with respect to deficiencies or payments for taxable years beginning after July 30, 1996. Therefore, each reference in this discussion to an "error or delay" refers to "an error or delay in performing a ministerial act" for taxable years beginning on or before July 30, 1996, and "unreasonable error or delay in performing a ministerial or managerial act" for taxable years beginning after July 30, 1996.

6.40 Authority to Abate Interest Accrued
The Service has the authority to abate only the amount of interest that accrued during the period attributable to an error or delay in performing the ministerial or managerial act. Section 6404(e)(1) applies only to an error or delay that occurs after the date the Service contacts the taxpayer in writing with respect to the deficiency or payment. Accordingly, there is no abatement of interest applicable from the return due date to the date the Service first contacts the taxpayer in writing, except as noted in paragraph 6.80.
6.50 Jurisdiction
The Tax Court has jurisdiction to review the Commissioner's failure to abate interest only when each of the following requirements has been met: a) The taxpayer filed a request for abatement of interest (generally via Form 843) with the Service after July 30, 1996, or the Service did not deny the request prior to July 31, 1996; b) the IRS mailed the taxpayer a notice of Final Determination not to abate interest; c) the taxpayer filed a petition for review with the Tax Court within 180 days of the mailing of the Final Determination notice; and d) the taxpayer meets the net worth requirements of I.R.C. § 7430(c)(4)(A)(ii).

6.60 Suspension of Interest Before 11-25-07
The Internal Revenue Service Restructuring Act suspends the accrual of certain penalties and interest after eighteen (18) months if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability for additional taxes (and the basis for the liability) within eighteen (18) months following the date that is the later of (1) the original due date of the return or (2) the date on which the individual taxpayer timely filed the return. The suspension only applies to individuals who file a timely tax return and does not apply to the failure to pay penalty, in the case of fraud, or with respect to criminal penalties. The provision is effective for taxable years ending after the date of enactment. With respect to taxable years beginning before January 1, 2004, the eighteen (18) month period is decreased to twelve (12) months. Interest and penalties resume 21 days after the IRS sends a notice to the taxpayer specifically stating the taxpayer's liability and the basis for the liability. The provision is applied separately with respect to each item or adjustment. [Act '3305] [IRC '6404(g)]

6.65 Small Business and Work Opportunity Tax Act of 2007,
The Small Business and Work Opportunity Tax Act of 2007, Pub. L. No. 110-028, § 8242, 121 Stat. 190, 200 (May 25, 2007), applies to notices under section 6404(g)(1) that are issued on or after November 26, 2007. The Act extends to thirty-six months the period within which the Service may issue a notice to an individual taxpayer specifically stating the taxpayer's liability and the basis for that liability before the accrual of interest and certain penalties are suspended under section 6404(g). The Service applies the following rules to notices issued on or after November 26, 2007, that relate to a return that was timely filed before that date.

1. If, as of November 25, 2007, the eighteen-month period has closed and the Service has not provided notice to the taxpayer, interest and applicable penalties will be suspended beginning on the day after the close of the eighteen-month period and ending on the date that is twenty-one days after the notice is provided.

2. In all other cases, interest and applicable penalties will be suspended beginning on the day after the close of the thirty-six month period and ending on the date that is twenty-one days after the notice is provided.

The following examples illustrate these rules. The examples assume that none of the exceptions in section 6404(g)(2) to the general rule for suspension applies. The dates in the
examples are used to illustrate the effective date changes made by the Act and do not provide guidance as to the computation of interest generally.

**Example 1:** An individual files a federal income tax return for 2006 by April 17, 2007 (the last day to timely file pursuant to section 7503). On January 2, 2009 (less than thirty-six months after the due date of the return), the Service provides a notice to the taxpayer specifically stating the taxpayer’s liability and the basis for the liability. Because the eighteen-month period has not closed as of November 25, 2007, interest and applicable penalties will not be suspended with respect to the taxpayer’s return.

**Example 2:** An individual files a federal income tax return for 2005 by April 17, 2006 (the last day to timely file pursuant to section 7503). On December 26, 2007, the Service provides a notice to the taxpayer specifically stating the taxpayer’s liability and the basis for the liability. Because the eighteen-month period has closed as of November 25, 2007, interest and applicable penalties will be suspended with respect to the taxpayer’s return beginning on October 17, 2007 (the day after the close of the eighteen-month period), and ending on January 16, 2008 (the date that is twenty-one days after the notice is provided).

**Example 3:** An individual files a federal income tax return for 2006 by April 17, 2007 (the last day to timely file pursuant to section 7503). The individual consents to extend the time within which the Service may assess any tax due on the return until June 30, 2011. On December 20, 2010, the Service provides a notice to the taxpayer specifically stating the taxpayer’s liability and the basis for the liability. Because the eighteen-month period has not closed as of November 25, 2007, interest and applicable penalties will be suspended beginning on April 17, 2010 (the day after the close of the thirty-six month period), and ending on January 10, 2011 (the date that is twenty-one days after the notice is provided).

6.70 **Abatement of Interest in Presidential Declared Disaster Areas**
The Internal Revenue Service Restructuring Act provides that taxpayers located in a Presidential declared disaster area do not have to pay interest on taxes due for the length of any extension for filing their tax returns granted by the Secretary of the Treasury, effective for disasters declared after December 31, 1997, with respect to taxable years beginning after December 31, 1997. The provision is designated as emergency legislation under Section 252(e) of the Balanced Budget and Emergency Deficit Control Act. [Act '3309] [IRC '6404(h)]

6.80 **Notice of Interest Charges**
The Act requires every IRS notice that includes an amount of interest required to be paid by the taxpayer that is sent to an individual taxpayer to include a detailed computation of the interest charged and a citation to the Code section under which such interest is imposed, effective for notices issued after December 31, 2000. [3308] [IRC '6631]
EXHIBITS
March 24, 2002

VIA CERTIFIED MAIL NO.: Z 484 547 059
RETURN RECEIPT REQUESTED

Internal Revenue Service
Kansas City, MO 64999

Re: 1995 Income Taxes
Minnie Excuses
SSN: 999-99-1234

Gentlemen & Ladies:

We believe that Minnie Excuses has reasonable cause for having failed to pay her taxes on a timely basis. **We request that you abate the late filing and late payment penalties totaling $3,133.51, and interest which has accrued on these penalties, against Minnie Excuses.** Notice of these penalty assessments for 1995 is attached hereto. Enclosed is our Power of Attorney on behalf of the taxpayer.

**Facts**

Minnie Excuses was divorced in November, 1989. As a result of the divorce, she became a single mother and was left with the responsibility of raising three children. Her divorce provided for alimony and child-support. It was not clear to Ms. Excuses at the time of her divorce that all payments to her by her ex-spouse would be considered to be taxable to her. On May 21, 1991, Minnie Excuses suffered a severe shoulder injury. That injury resulted in multiple surgeries. She continues to suffer pain from the injury. Part of her shoulder bone is dead and the only remaining option to resolve the pain would be an amputation of her arm. She has chosen instead to continue dealing with pain. That pain is treated with medication, but cannot be fully abated by any conventional medical means. (See attached letter from Dr. Scalpel.)

Subsequent to her divorce and injury, Ms. Excuses continued to have other personal problems. Her ex-husband initiated annulment proceedings with the Catholic Church so he could remarry. The pressures of the divorce and physical illness caused Minnie Excuses to go into severe depression. Her depression worsened to the point where she sought psychological treatment. She received ongoing psychological treatment from 1990 to 1994. In 1994 she began treating with Ima Shrink.

We have enclosed a letter from Dr. Shrink setting forth the nature and extent of Ms. Excuses's depression. Ms. Excuses continues to see Dr. Shrink and is being treated with medications.

As a direct result of her physical and psychological illnesses, Minnie Excuses was unable to file and pay her income taxes for 1995 until 1998. Ms. Excuses filed her 1997 tax return on a timely basis. Her psychological illness is now somewhat abated by her continued treatment by Dr. Shrink and by medications which have allowed the symptoms to abate. It is likely that she will continue treatment for her illnesses into the future.
Discussion

The Internal Revenue Service Penalty Handbook provide the following grounds for non-assertion or abatement of penalties:

A. "Reasonable Cause"

(1) Reasonable cause is based on all the facts and circumstances in each situation and allows the Service to provide relief from a penalty that would otherwise be assessed. Reasonable cause relief is generally granted when the taxpayer exercises ordinary business care and prudence in determining his/her tax obligations but is unable to comply with those obligations.

(2) In the interest of equitable treatment of the taxpayer and effective tax administration, the nonassertion or abatement of civil penalties based on reasonable cause or other relief provisions provided in this IRM must be made in a consistent manner and should conform with the considerations specified in the Internal Revenue Code (IRC), Regulations (Treas Regs), Policy Statements and Part XX.

The Internal Revenue Manual defines ordinary business care and prudence as: "Ordinary business care and prudence includes making provisions for business obligations to be met when reasonably foreseeable events occur. A taxpayer may establish reasonable cause by providing facts and circumstances showing the taxpayer exercised ordinary business care and prudence (taking that degree of care that the reasonable person would exercise) but nevertheless was unable to comply with the law.

The IRM (20)132.4 provides in pertinent part:

B. Death, Serious Illness, or Unavoidable Absences

Death, serious illness, or unavoidable absence of the taxpayer may establish reasonable cause for late filing, payment, or deposit, for:

An individual

If there was a death, serious illness or unavoidable absence of the taxpayer or a death or serious illness in that taxpayers immediate family (i.e., spouse, sibling, parents, grandparents, children) - PRC 24 indicates the incident occurred to the individual or a member of that individuals immediate family for filing, paying or depositing.

Discussion

In the instant case, Minnie Excuses suffered from serious illnesses during the entire time that she failed to file and pay her tax return. She was suffering from depression and from serious physical ailments. She also had the sole responsibility for raising three children. As a direct and proximate result of Ms. Excuses's illnesses, she was unable to meet her obligations to file and pay her tax returns on a timely basis. As a result of her severe depression, she could barely face each day. She was forced to spend extended periods of time seeking medical advice and treatment. She also had the obligation to raise her family. As a result of these problems, Ms. Minnie Excuses did not file her tax returns on a timely basis. Beginning with her 1997 return, Ms. Minnie Excuses began filing
tax returns on a timely basis. She sought a refinancing of her home so that she could pay her obligations. We, therefore, request that the Service abate penalties assessed against Minnie Excuses for 1995 of $1,831.27 for filing and paying late, $1,302.24 for paying late, and the interest which has accrued on these penalties, based upon a determination of reasonable cause. If you have any questions regarding this matter, please call me.

Very truly yours,

Robert E. McKenzie
REM/pm

cc: Minnie Excuses
March 9, 2009

Via Facsimile: 563-328-4452
Mr. John H. Officer
Internal Revenue Service
101 W. 2nd Street, 6th Floor
Davenport, IA 52801

Re: Nursing Home Supportive Living Center, LLC
   FEIN: 36-0000000
   Request for Abatement of Penalties 941, 2nd, 3rd, 4th Quarter 2006
   Request for Abatement of Penalties 941, 1st, 2nd, 3rd Quarter, 2007
   Request for Abatement of Penalties 941, 1st, 2nd, 3rd Quarter, 2008
   Request for Abatement of Penalties 940, 2006, 2007

Dear Mr. Mills:

We have received your correspondence of February 26, 2009 containing the balances of tax, interest and penalties due for Nursing Home Living Center, LLC. (copy of letter attached). We believe that Nursing Home Supportive Living Center, LLC, (hereinafter “Nursing Home”) had reasonable cause for having failed to file and to pay its taxes on a timely basis. We request that you abate the federal tax deposit penalties, failure to file, failure to pay penalties, and late filing penalties and the interest assessed on these penalties in connection with its 941 and 940 tax liabilities for tax periods listed above on the basis of reasonable cause.

Facts*

Nursing Home Supportive Living Center, LLC operates a facility which converted to a supportive living facility during 2004 and 2005. Nursing Home has a resident population of beds occupied primarily by recipients of Medicaid. Nursing Home’s business suffered substantially over the course of the economic downturn in Illinois over the last several years and in the United States recession. Specifically, during the periods at issue, the facility had serious cash flow difficulties and as a result it was unable to pay its bills.

In January, 2008, when Bank of America bought LaSalle Bank, the new bank refused to extend Nursing Home’s line of credit, called its loan and offset the cash in Nursing Home’s bank accounts against LaSalle's balance due on its loan, causing cash flow difficulties for the business during the first 3 quarters of 2008. It has taken Nursing Home until March, 2009 to locate another lender who might be willing replace Bank of America/LaSalle Bank. The United States economy is in a serious recession if not in a depression, and the government of the State of Illinois is in disarray with the impeachment of our governor.
The State of Illinois is extremely delinquent in reimbursement of its payments to Illinois providers. Nursing Home failed to pay certain employment taxes because the State of Illinois Medicaid reimbursement cut reimbursements to provider facilities and because the State of Illinois has lagged in payment to provider facilities from 150 days during 2002 and later years, to its current lag time of 30 to 90 days. Nursing Home has an Illinois statutory duty to provide medical and residential care to its Medicaid recipients. Please see portions of T. LeBlang, W. Basanta, R. Kane, The Law of Medical Practice in Illinois, (update), at 2003 update pages 53, 54 (for Page 130, footnote 50) (1996, 2003) attached as Exhibit A.

It was not foreseeable to Nursing Home that the State of Illinois would cut the rates of reimbursement the State of Illinois paid to its Medicaid Recipients, and at the same time the State of Illinois would delay payment to the providers of services to the State of Illinois Medicaid recipients by such lengthy time periods. Nursing Home had no control over the actions of the State of Illinois with respect to the reductions of reimbursement instituted by the State of Illinois Public Aid/Medicaid reimbursement program, or over the slow payment of its bills by the State of Illinois.

Nursing Home could not increase rates to its residents covered by State Medicaid to cover the reduction in State of Illinois reimbursements. The Illinois Public Aid Code provides that it is a business offense, carrying a fine of between $5,000 and $25,000 for a nursing home or other facility to charge Medicaid residents any additional amounts for covered services beyond the rates established by the IDPA. 305 ILCS 5/8A-11 and LeBlang, supra 2003 (update) at 484. During the period of change from a nursing home to a supportive living center, the City of Nursing Home refused to allow new patients to enter the facility, and the facility’s income dropped even further as its bed count reduced through attrition.

Nursing Home could not ask its Public Aid/Medicaid residents to move or to find other supportive living housing because the reimbursements to Nursing Home had been cut by the Illinois Department of Public Aid/Medicaid programs. One Hundred Fourteen Nursing Home residents have no where else to live. Under the Illinois Public Aid Code, such an action is also a business offense with fines from $500 to $5,000. See LeBlang, supra, 2003 (update) at 484.

Nursing Home could not cover the shortfall created by the State of Illinois’s reduction in reimbursements and the State of Illinois’s lagging revenue payments by cutting Nursing Home’s payroll, or its costs for supplies. Nursing Home, by State of Illinois mandate, could not reduce the medical, nursing and skilled care to be provided to its supportive living center residents or reduce the standard of living (medicines, medical supplies, semi-skilled care, food, electricity, heat, clothing, etc.) provided to its supportive living center residents, despite the reduction in payment on behalf of those residents by the State of Illinois. To do so could have resulted in the suspension of its Illinois operating license, its certifications to participate in the Medicaid programs, and possibly subject the licensee and its employees to criminal charges. LeBlang, supra, 2003 (update), 467, 474, 476, and 477. The employees of Nursing Home and the vendors who provided medicines, medical supplies,
food, electricity, heat, and clothing to the Nursing Home facility would have refused to provide continued services to Nursing Home if their salaries and accounts were not paid or partially paid.

Nursing Home exercised ordinary business care and prudence in determining its tax obligations but was unable to comply with those obligations. The State of Illinois Public Aid funding cut, and the State of Illinois slow payment, and the fact that almost all of the Nursing Home residents are Public Aid/Medicaid recipients without alternative housing, were circumstances beyond the taxpayer's control. While Nursing Home exercised ordinary care and business prudence, these circumstances prevented Nursing Home from timely meeting its tax obligations.

The State of Illinois announced (on about October 19, 2005) that it would take out a $1 billion short-term loan to cover some of its outstanding obligations to hospitals, pharmacies and nursing homes, among others. See Chicago Daily Herald, October 19, 2005, at 7, col. 1 to 3, attached as Exhibit B. The State of Illinois still continues to be one to three months behind in payments to nursing homes and other facilities.

Nursing Home provided medical and residential supportive services to its Public Aid Recipient Residents as mandated by Illinois laws, including the Abused and Neglected Long-Term Care Facility Resident Reporting Act, 210 ILCS 30/1 et seq., the Illinois Public Aid Code, 406 ILCS 5/ A-11 et seq., and the Illinois Nursing Home Care Reform Act, 210 ILCS 45/1-101 et seq., during the period when the State of Illinois cut nursing home funding and when the State of Illinois lagged up to six months in its payments to nursing homes. Nursing Home is only now beginning to catch up and recoup some of its losses incurred during these prior periods.

In the exercise of ordinary care and business prudence, Nursing Home now utilizes a payroll company to prepare its payroll and to make EFTPS payroll tax deposits.

**Statement of Law**

The taxpayer's failure to timely file, deposit and pay the tax due with its returns is due to reasonable cause and not willful neglect. In United States v. Boyle, 469 U.S. 241, 105 S. Ct. 687, 83 L. Ed. 2d 622 (1985), the Court noted:

To escape the penalty, the taxpayer bears the...burden of proving both (1) that the failure did not result from “willful neglect,” and (2) that the failure was “due to reasonable cause.” 26 U.S.C. 6651 (a) (1).

Section 6724 of the Internal Revenue Code provides that no penalty shall be asserted if such failure to timely file (or pay) was due to reasonable cause and not willful neglect. Although reasonable cause is typically determined on a case by case basis, relief based upon reasonable cause is usually granted when the taxpayer exercises ordinary business care and prudence in determining his or her tax obligations.
The Internal Revenue Service Penalty Handbook provides the following grounds for non-assertion or abatement of penalties:

"20.1.1.3.1 Reasonable Cause

(1) Reasonable cause is based on all the facts and circumstances in each situation and allows the Service to provide relief from a penalty that would otherwise be assessed. Reasonable cause relief is generally granted when the taxpayer exercises ordinary business care and prudence in determining his/her tax obligations but is unable to comply with those obligations.

(2) In the interest of equitable treatment of the taxpayer and effective tax administration, the nonassertion or abatement of civil penalties based on reasonable cause or other relief provisions provided in this IRM must be made in a consistent manner and should conform with the considerations specified in the Internal Revenue Code (IRC), Regulations (Treas Regs), Policy Statements and Part 20.1."

A. Ordinary Business Care and Prudence

The IRM in Section 20.1.1.3.1.2 defines ordinary business care and prudence as:

"Ordinary business care and prudence includes making provisions for business obligations to be met when reasonably foreseeable events occur. A taxpayer may establish reasonable cause by providing facts and circumstances showing the taxpayer exercised ordinary business care and prudence (taking that degree of care that the reasonable person would exercise) but nevertheless was unable to comply with the law."

B. Circumstances Beyond Taxpayer's Control

The IRM also provides relief for “circumstances beyond the taxpayer’s control”:

"Consider whether or not the taxpayer could have anticipated the event that caused the noncompliance. Reasonable cause is generally established when the taxpayer exercises ordinary business care and prudence but, due to circumstances beyond the taxpayer's control, the taxpayer was unable to timely meet the tax obligation. The taxpayer's obligation to meet the tax law requirements is ongoing. Ordinary business care and prudence requires that the taxpayer continue to attempt to meet the requirements, even though late." (IRM Sec. 20.1.1.3.1.2(d))

In addition, the IRM also states:

(1) "The taxpayer may try to establish reasonable cause by claiming that a mistake was made..." (IRM 20.1.1.3.1.2.2)
“(1) The taxpayer may try to establish reasonable cause by claiming forgetfulness or an oversight by the taxpayer or another party caused the noncompliance.” (IRM 20.1.1.3.1.2.3)

Discussion

Nursing Home Supportive Living Center, LLC had reasonable cause for the accrual of its outstanding liabilities during the entire time that it has failed to pay its taxes. As a direct and proximate actions of the State of Illinois and of the LaSalle Bank, and Nursing Home’s statutory duty to provide care to its Medicaid resident recipients, Nursing Home was unable to pay certain employment taxes. Nursing Home exercised ordinary business care and prudence in determining its tax obligations and paying its taxes, but due to circumstances beyond the taxpayers’ control, and in circumstances which would have created undue hardship for its Public Aid/Medicaid Residents in violation of Abused and Neglected Long-Term Care Facility Resident Reporting Act, 210 ILCS 30/1 et seq., the Illinois Public Aid Code, 406 ILCS 5/ A-11 et seq, and the Illinois Nursing Home Care Reform Act, 210 ILCS 45/1-101 et seq, it was unable to comply with those tax obligations and pay all of its taxes.

We therefore request that the Internal Revenue Service abate the failure to deposit penalties, failure to file, failure to pay penalties and paying late penalties and the interest assessed on these penalties in connection with the 941 tax periods for the 2nd, 3rd, 4th Quarter 2006, the 1st, 2nd, 3rd, Quarter, 2007 and the 1st, 2nd and 3rd Quarter, 2008 and the 940 tax periods for 2006 and 2007 assessed against Nursing Home Supportive Living Center, LLC, based on a determination of reasonable cause.

Sincerely,

Robert E. McKenzie

REM/pp
Enclosures

cc: Client
## 2011 IRS Penalties

Table 17. Civil Penalties Assessed and Abated, by Type of Tax and Type of Penalty, Fiscal Year 2011 [1]

(Money amounts are in thousands of dollars)

<table>
<thead>
<tr>
<th>Type of tax and type of penalty</th>
<th>Civil penalties assessed</th>
<th>Civil penalties abated [2]</th>
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<tr>
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<td>Number</td>
<td>Amount</td>
</tr>
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<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
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<td>Civil penalties, total</td>
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<td>Accuracy [4]</td>
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<td>1,112,671</td>
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<td>296,559</td>
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<td>Delinquency</td>
<td>3,736,987</td>
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<td>Estimated tax</td>
<td>7,366,907</td>
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<td>Failure to pay</td>
<td>16,841,952</td>
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<td>Fraud</td>
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<td>186,116</td>
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<td>Other [5]</td>
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<td>Business income tax:</td>
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<td>Civil penalties, total</td>
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<td>Accuracy [4, 6]</td>
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<td>Failure to pay [6]</td>
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<td>S corporation/partnership information [7]</td>
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<td>Other [6]</td>
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<td>4,447</td>
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<td>Employment taxes:</td>
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<td>Civil penalties, total [8]</td>
<td>7,745,830</td>
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<td>Accuracy [4]</td>
<td>2,590</td>
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<td>Failure to pay</td>
<td>4,162,673</td>
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<td>Federal tax deposits</td>
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<td>Fraud</td>
<td>256</td>
<td>3,404</td>
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<td>Other</td>
<td>246</td>
<td>6,447</td>
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<td>Excise taxes:</td>
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<td>Accuracy [4]</td>
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<td>Federal tax deposits</td>
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<td>Fraud</td>
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<td>d</td>
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<td>Estate and gift tax:</td>
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<td>Civil penalties, total [11]</td>
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<td>Fraud</td>
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<td>0</td>
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<td>Other</td>
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<td>Nonreturn penalties [12]</td>
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