

Reliance on Professional Advice -Reasonable Cause

Event Name: Reliance on Professional Advice -Reasonable Cause (PHJ761527)

Subject Name:

Leader:

(b) (6)

Presenters:

Lindsey Stellwagen (Lindsey)

Start Time:

(b) (6)

5/14/13 10:00 am

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**Reliance on Paid Professional_ Reasonable Cause
51313.ppt**

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Reasonable Cause: Reliance on Professional as Defense to Penalties

Offshore Arrangements Network Event

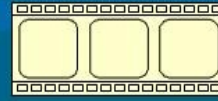


Reasonable Cause:
Reliance on Professional as Defense to Penalties



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Welcome

Welcome

Welcome from IIC IPN Management:

Roula Karavitis,
IIC Senior IPN Program Manager



Presenters

Presenters

❖ **John McDougal**

SB/SE, Special Trial Attorney

❖ **Lindsey Stellwagen**

SB/SE, Special Counsel International



Penalties With Reasonable Cause Exception

Penalties With Reasonable Cause Exception

- I.R.C. § 6651** – penalty imposed for failure to file "unless it is shown that such failure is due to reasonable cause and not due to willful neglect"
- I.R.C. § 6664(c)** – accuracy penalties not imposed "if it shown that there was a reasonable cause . . . and that the taxpayer acted in good faith"
- I.R.C. § 6038(c)(4)(B) (5471)** – 5471 is not counted as due until "the last day on which (as shown to the satisfaction of the Secretary) reasonable cause existed for failure to furnish such information"
- I.R.C. § 6038D (New form 8938)** – no penalty on failure to file "which is shown to be due to reasonable cause and not due to willful neglect"
- I.R.C. § 6039F (3520 for large foreign gifts)** – no penalty "if the United States person shows that the failure is due to reasonable cause and not due to willful neglect"
- I.R.C. § 6677(d) (3520s, 3520As)** – no penalty on failure to file "which is shown to be due to reasonable cause and not due to willful neglect"
- 31 U.S.C § 5321(a)(5)(B)(ii) (FBAR)** – no penalty imposed "with respect to any violation if – (I) such violation was due to reasonable cause, and (II) the amount of the transaction or the balance in the account at the time of the transaction was properly reported."

General Rules on Reasonable Cause

General Rules on Reasonable Cause

The IRS always bears the “burden of production” on penalties. The IRS must show it is appropriate to impose the penalty.

- IRC § 7491(c)
- Higbee v. Commissioner, 116 T.C. 438, 446 (2001).
- In context of an FBAR penalty, government must establish by a preponderance of the evidence. US v. Williams, No. 1:09-cv-437, 2010WL 347331 (ED VA Sept 1, 2010) rev'd other grounds, 489 Fed. Appx. 655(4th Cir. 2012).

Once the IRS shows the penalty is appropriate, it will apply unless the taxpayer shows reasonable cause.

- United States v. Boyle, 469 U.S. 241 (1985).

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General Rules on Reasonable Cause

To avoid penalty, taxpayer must show he acted with “reasonable cause” and in “good faith.”

I.R.C. § 6664(c)(1).

“Reasonable cause” requires the taxpayer to exercise ordinary business care and prudence to the disputed item.

“Good faith” has no precise definition but means an honest belief and intent to perform all lawful obligations.

Contrast Objective and Subjective Standards

Contrast Objective and Subjective Standards

For fraud or criminal willfulness we use a subjective test-- “what was in this taxpayer’s mind?”

But for reasonable cause we use an objective test—“what should a normal person have known/done?” We ask, “Did this taxpayer act like an ordinary, reasonable, prudent person?”

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Considerations

Reasonable cause is established on a case-by-case basis.

Review all pertinent facts and circumstances.

Review the taxpayer's knowledge and experience.

Consider if there is an honest mistake of fact or law.

Consider the taxpayer's efforts to assess the proper liability.

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Reliance on a Professional

One way a taxpayer can establish reasonable cause is to show reliance on the advice of an independent professional such as a tax advisor, lawyer, accountant or the IRS.

The advice can be written or oral. However, oral advice from the IRS does not guarantee penalty relief. See IRM 20.1.1.3.3.4.2.

There are distinct, objective showings that the taxpayer must establish.

What is "Advice"?

What is "Advice"?

The taxpayer must first show that "advice" on the disputed item was given.

Advice must be based on all pertinent facts and circumstances and the law as it relates to those facts and circumstances. Treas. Reg. § 1.6664-4(c)(i)

Advice may not be based on unreasonable factual and legal assumptions or unreasonably rely on facts supplied by third parties. Treas. Reg. § 1.6664-4(c)(ii)

Advice is any communication "setting forth the analysis or conclusion" of the advisor upon which the taxpayer relies with respect to the I.R.C. § 6662 penalty. Treas. Reg. § 1.6664-4(c)(2)

(The regulation sets forth additional criteria for tax shelters and section 482 cases.)

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What is “Advice”?

Leaving an item off a return without any analysis is not “advice” of the preparer.

➤ Woodsum v. Commissioner, 136 T.C. 585 (2011).

Preparing a tax return is not by itself evidence that a CPA opined on any or all of the line items.

➤ Neonatology Associates, P.A. v. Commissioner, 115 T.C. 43, 100 (2000).

Contrast “Reliance on Advice” With “Delegation of Filing Duty”

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Not preparing a return can be implied advice that nothing is required if the taxpayer provided all critical facts to an expert and asked him to prepare whatever forms are required.

- Hatfried v. Commissioner, 162 F.2d 628 (3rd Cir. (1947)).

But if you know a return is required you can't just hand your information to a professional and rely on him to file on time.

- United States v. Boyle, 469 U.S. 241, 246 (1985).

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Consider

In offshore cases:

“The banker didn’t tell me” – this is not advice.

Interview the taxpayer’s professional—it is unlikely s/he advised that the money earned and/or held offshore was not taxable.

If the taxpayer did not receive “advice” there is no reasonable cause.

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Three-Prong Test

Once the taxpayer has shown “advice” was given, the taxpayer must meet a three-prong test to establish reliance on a professional.

1. The taxpayer selected a competent advisor with sufficient expertise to justify reliance.
2. The taxpayer supplied the adviser with the necessary and accurate information.
3. The taxpayer actually relied in good faith on the adviser’s judgment.

Neonatology Assocs., P.A. v. Commissioner, 115 T.C. 43,99 (2000), aff’d, 299 F.3d 221 (3d Cir. 2002).

Competence of Advisor

Competence of Advisor

Prong 1: The taxpayer selected a competent advisor with sufficient expertise to justify reliance.

Did the advisor have international tax expertise or does it look like the taxpayer selected the advisor because he was unsophisticated?

- Patin v. Commissioner, 88 T.C. 1086 (1987).

Did the taxpayer change advisors?

What if the taxpayer relied on advice from an advisor in a foreign country?

What if the advice came from the taxpayer's banker?

- Mayflower Investment Company v. Commissioner, 24 T.C. 729 (1955).

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Consider

In offshore cases:

The taxpayers are typically wealthy. It may be unreasonable for them to fail to seek competent tax advice.

Look carefully at the quality and the source of the advice upon which the taxpayer is “relying.”

Disclosure of Facts

Disclosure of Facts

Prong 2: The taxpayer supplied the adviser with the necessary and accurate information.

Failure to disclose critical facts to advisor renders reliance unreasonable

- Yale Avenue Corporation v. Commissioner, 58 T.C. 1062 (1972).
- Leonhart v. Commissioner, 414 F.2d 749 (4th Cir. 1969).
- Diaz v. Commissioner, T.C. Memo 2012-280.

The burden is on the taxpayer to prove that all facts were disclosed

- Fourth & Railroad Realty Co. v. Commissioner, 25 T.C. 458 (1955).
- InterTAN, Inc. v. Commissioner, T.C. Memo 2004-1.

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Consider

In offshore cases:

Taxpayers often do not disclose their offshore activities to their return preparer. Interview the return preparer carefully. Ask for the “tax planner” or “tax organizer” completed by the taxpayer.

Taxpayers may state that a foreign professional told them the money was not taxable until it was repatriated to the U.S. What did they tell/ask their U.S. tax return preparer? What documents did they disclose to the preparer? Was it reasonable for them to rely upon a foreign professional? Did they consult domestic professionals? If not, why not?

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Good Faith Reliance

Prong 3: The taxpayer actually relied in good faith on the adviser's judgment.

Do the circumstances show that the taxpayer actually relied on the advice?

- Estate of Young v. Commissioner, 110 T.C. 297 (1998).

Negligent mistake of preparer is not reasonable cause, if taxpayer was in a position to notice the error on reviewing the return

- Pritchett v. Commissioner, 63 T.C. 149 (1974).

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Consider

In offshore cases:

The Regulations state that a taxpayer cannot rely upon advice or an assumption the taxpayer knows—or has reason to know—is unlikely to be true.

- Treas. Reg. § 1.6664-4(c)(ii)

A taxpayer who flies to a foreign tax haven, meets with private bankers, sets up secret accounts and structures, establishes code words, asks for statements not to be sent to the U.S., and fails to report this offshore income will generally not meet this standard!

What do Turnip Trucks have to do with it?

What do Turnip Trucks have to do with it?

Woods v. United States, 794 F. Supp. 2d 714 (W.D. Texas, 2011).

➤“Although Plaintiff Woods may not have qualified as a “tax specialist,” he was a far cry from a man who had just fallen off a turnip truck. His wealth of knowledge and experience should have alerted him to the fact that the COBRA scheme was simply ‘too good to be true.’”

➤Regs. 1.6664-4(c): “taxpayer’s education, sophistication, and business experience will be relevant in determining whether taxpayer’s reliance on tax advice was reasonable and made in good faith.”

Other Good Faith Factors

Other Good Faith Factors

Was opinion received before position claimed on tax return?

Was opinion reviewed and considered?

How much detail was included?

Was the advisor independent?

What is the taxpayer's level of education, business knowledge, and familiarity with tax?

Reliance in Filing Context

Reliance in Filing Context

Ignorance of a filing requirement is not reasonable cause unless the taxpayer made inquiry of a knowledgeable expert and was misinformed.

- > Henningsen v. Commissioner, 243 F.2d 954, 958 (4th Cir. 1957).
(income tax return)
- > Janpol v. Commissioner, 102 T.C. 499, 504-05 (1994).
(returns of excise tax on profit sharing trust prohibited transactions)
- > N.Y. State Assn. Real Est. Bd. Group Ins. Fund v. Commissioner, 54 T.C. 1325, 1336 (1970).
(exempt org business income tax returns)
- > Heman v. Commissioner, 32 T.C. 479, 490 (1959).
(domestic trust returns)
- > Coshocton Securities Co. v. Commissioner, 26 T.C. 935, 939 (1956).
(personal holding company returns).

Brian Chivas James v. United States Case No. 8:11-cv-271-T-30AEP (M.D.FI.)

Brian Chivas James v. United States

Case No. 8:11-cv-271-T-30AEP (M.D.FI.)

Issue: Filing Requirement

Taxpayer set up a Nevis Trust. His preparer prepared and filed Forms 3520-A in each year.

However, the Forms 3520 reporting contributions into the trust were not filed.

Section 6677(d) provides that no penalty shall be imposed if the failure to file was “due to reasonable cause and not willful neglect.”

The taxpayer claimed he was not liable for the penalty due to reasonable cause because his preparer failed to advise him of the Form 3520 filing requirement.

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Brian Chivas James v. United States

Case No. 8:11-cv-271-T-30AEP (M.D.FI.)

The Court denied the government's Motion for Summary Judgment on Reasonable Cause and the case went to a trial.

The Court instructed the jury that:

1. ignorance of the law is not reasonable cause unless TP made reasonable inquiry or could not reasonably be expected to know of requirement; and
2. willful neglect includes reckless indifference

The jury held for the government, finding the taxpayer's failure to file the Forms 3520 were based on his willful neglect.

Reliance in FBAR Context

Reliance in FBAR Context

U.S. v. McBride, 2012 U.S. Dist. LEXIS 161206 (D. Utah 2012).

McBride could not rely on the advice of the person who designed his “Master Financial Plan” and who told him the structure legally eliminated the need to report on his taxes because,

- Promoter had an inherent conflict of interest
- No showing the promoter had any legal expertise

McBride could not rely on his tax return preparer because he never told the preparer he had a foreign account.

McBride could not rely on the failure of another advisor to give him correct advice because he had independent knowledge his tax scheme was risky.

McBride’s failure to affirmatively seek legal advice on a matter known to be risky was reckless.

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Case Development

The questions to ask of the taxpayer and advisor should focus on the requirements of the defense:

Advice: What was the advice given?

Advisor: Who was the advisor?

- a tax advisor, lawyer, banker, promoter or return preparer?
- How did taxpayer find the advisor, why, and when?

Disclosure: Facts provided by taxpayer to the advisor

- What did the taxpayer tell the advisor? Develop fully, particularly with respect to any offshore structures and accounts.
- What did the advisor tell the taxpayer? Get details of the advice.
- Get copies of all written advice.
- Secure accountant/advisor workpapers
- Obtain the tax planner completed by the taxpayer

Reliance: Was the alleged “reliance” reasonable?

Reliance Scenarios

Reliance Scenarios

TP gives preparer complete information, including bank statements for his foreign account. TP tells the return preparer “prepare whatever I have to file.” Preparer reports the foreign interest but checks “No” box and prepares no FBAR.

- Boyle delegation or implied advice?
- What additional information would you want?
 - About the taxpayer?
 - About the return preparer?

Suppose preparer knows TP is a wealthy immigrant but fails to ask about foreign accounts?

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Develop the Facts

What if the advisor tells the taxpayer he is a new employee with no foreign experience?

What if the advisor is the taxpayer's brother-in-law?

What if the taxpayer is an attorney?

What if the advisor said he wasn't "positive" but was "pretty sure" an FBAR wasn't required?

What if the taxpayer has \$10M in the account and goes to H&R Block?

What if taxpayer has filed FBARs in the past and says nothing?

What if the taxpayer has a high school education and inherited the account from his grandmother?

What if the accountant does not report the income on the account and the taxpayer knows "it is too good to be true?"

No Slide Title 33



Questions?