The Age of Promoter Penalties: Fighting the Good Fight

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The Age of Promoter Penalties

• Introduction to penalty provisions

• Enforcement Overview
  o TIGTA July 2018 Report: “The Internal Revenue Service Lacks a Coordinated Strategy to Address Unregulated Return Preparer Misconduct”
  o Strategy for promoter investigations has changed in mid-to-late-2019

• Areas of focus
  o Captive Insurance Companies
  o Syndicated Conservations Easements
  o International tax avoidance schemes
  o Other structures

• Voluntary Settlement Initiatives

• Promoter Audits Tips

• Options for promoters’ clients
Preparer, Promoter, and Material Adviser Penalties

- 26 U.S.C. § 6694  Understatement of taxpayer’s liability by tax return preparer
- 26 U.S.C. § 6695  Other assessable penalties with respect to the preparation of tax returns for other persons
- 26 U.S.C. § 6695A: Substantial and gross valuation misstatements attributable to incorrect appraisals
- 26 U.S.C. § 6700  Promoting abusive tax shelters
- 26 U.S.C. § 6701  Penalties for aiding and abetting understatement of tax liability
- 26 U.S.C. § 6707  Disclosure or use of information by preparers of returns
- 26 U.S.C. § 6707A  Failure to Disclose Reportable Transaction Information
- 26 U.S.C. § 6708  Failure to Maintain List of Advisees of Reportable Transactions
- 26 U.S.C. § 6713  Disclosure or Use of Information by Return Preparer
Preparer/Promoter Injunctions

• 26 U.S.C. § 7407  Action to enjoin tax return preparers

• 26 U.S.C. § 7408  Action to enjoin specified conduct related to tax shelters and reportable transactions

• 26 U.S.C. § 7402(a)  Injunctions “…necessary or appropriate for the enforcement of the internal revenue laws.”
  o Often brought in conjunction with § 7407 and/or § 7408
  o Government will increasingly seek disgorgement in addition to a permanent injunction under Section 7402(a)

• Professional sanctions under Circular 230 and referrals to the IRS-OPR
  o Censure, suspension or disbarment from continuing to practice before the IRS, and monetary penalties
<table>
<thead>
<tr>
<th></th>
<th>Combined Results (All Programs)</th>
<th>% of Whole</th>
<th>Abusive Return Preparer Program</th>
<th>% of Whole</th>
<th>Abusive Tax Schemes</th>
<th>% of Whole</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investigations initiated</td>
<td>2,485</td>
<td>100.00%</td>
<td>163</td>
<td>6.56%</td>
<td>69</td>
<td>2.78%</td>
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<tr>
<td>Prosecutions recommended</td>
<td>1,893</td>
<td>100.00%</td>
<td>203</td>
<td>10.72%</td>
<td>45</td>
<td>2.38%</td>
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<tr>
<td>Informations / indictments</td>
<td>1,800</td>
<td>100.00%</td>
<td>138</td>
<td>7.67%</td>
<td>25</td>
<td>1.39%</td>
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<tr>
<td>Sentenced</td>
<td>1,726</td>
<td>100.00%</td>
<td>154</td>
<td>8.92%</td>
<td>34</td>
<td>1.97%</td>
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<tr>
<td>Incarceration rate</td>
<td>79%</td>
<td>N/A</td>
<td>78%</td>
<td>N/A</td>
<td>71%</td>
<td>N/A</td>
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<tr>
<td>Average months served</td>
<td>43</td>
<td>N/A</td>
<td>24</td>
<td>N/A</td>
<td>31</td>
<td>N/A</td>
</tr>
</tbody>
</table>


• Imposition of penalty
  o Preparation of a tax return (including an amended income tax return) or a claim for refund which contains an unreasonable position that results in an understatement of tax and either
    • The position was properly disclosed, but there was no reasonable basis, for the position or
    • The position was not properly disclosed and there was not substantial authority for the position

• Amount of penalty
  o Unreasonable position: $1,000 or 50% of the income derived from return or the claim for refund;
  o Willful or reckless conduct: $5,000 or 50% of the income derived from return or the claim for refund

• Broad definition of tax return preparer

• Defenses
  o Adequate disclosure and a reasonable basis
  o Substantial authority
  o Reasonable cause and good faith
  o Noncompliance with 26 U.S.C. § 6751(b)(1)

- 26 U.S.C. § 6695(a) – Failure to furnish a copy of a return or claim for refund
  - $50 for each failure to furnish a copy of a return or claim for refund, $25,000 in total
  - Reasonable cause defense available

- 26 U.S.C. § 6695(b) – Failure to sign a tax return or claim for refund
  - $50 per failure to sign a return or claim for refund, $25,000 in total
  - Reasonable cause defense available

- 26 U.S.C. § 6695(c) – Failure to furnish PTIN
  - $50 per failure to provide PTIN to Service, $25,000 in total
  - Reasonable cause defense available

- 26 U.S.C. § 6695(d) – Failure to retain copy or tax returns or claim for refund
  - $50 for each failure to file a return as required by 26 U.S.C. § 6060
  - $50 for each failure to include a required item in the return
  - Maximum penalty of $25,000
  - Reasonable cause defense available

• 26 U.S.C. § 6695(e) – Failure to file a correct information statement
  o $50 for each failure to furnish the information statement, $25,000 in total
  o Reasonable cause defense available

• 26 U.S.C. § 6695(f) – Negotiation of a check
  o $500 for each check or electronic deposit improperly endorsed, no limit
  o Strict liability penalty

• 26 U.S.C. § 6695(g) – Failure to be diligent with EIC and head of household filing status
  o $500 for each failure to conduct required due diligence, no limit
  o Strict liability penalty
Aiding and Abetting Penalties – 26 U.S.C. § 6701

• Imposition of penalty
  o Authorized against any person who:
    • Aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document,
    • Knows or has reason to believe that such portion will be used in connection with any material matter arising under the internal revenue laws; and
    • Knows that such portion, if so used, would result in an understatement of the tax liability of another person.

• Amount of penalty
  o $1,000 for each false document (increased to $10,000 for corporate document)

• Anti-stacking provisions
  o No stacking with 26 U.S.C. §§ 6694 or 6700 penalties

• Applies to paid return preparers and promoters

• Imposition of penalty
  o Authorized against any person who:
    • Organizes or assists in the organization of a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement;
    • Participates, directly or indirectly, in the sale of any of the foregoing interests in any entity or plan or arrangement; and
    • In connection with such organization or sale, makes or furnishes or causes another to make or furnish
      o A statement with respect to the allowance of any deduction or credit, the excludability of any income, or the securing of any tax benefit by reason of holding an interest in the entity or participating in the plan or arrangement which the person knows or has reason to know is false or fraudulent as to any material matter, or
      o A gross valuation overstatement as to any material matter

• Amount of penalty
  o $1,000 for each activity or 100% of the gross income derived from the activity

• Anti-stacking provisions mixed
  o No stacking with 26 U.S.C. § 6701 penalty
  o Stacking allowed for other penalties (26 U.S.C. §§ 6694, 6695, 7206(2))
Abusive Tax Avoidance Schemes – 26 U.S.C. § 6700 (con’t)

- Statute of limitations
  - Unlimited (per IRS) vs. five-year limit under 28 U.S.C. § 2462
  - Assessable penalties eliminate existence of “action, suit or proceeding”
    - Capozzi v. United States, 980 F.2d 872, 874-875 (2d Cir. 1992)
Referrals to the IRS-OPR

• Professional sanctions and monetary penalties
  o Censure, suspension or disbarment from continuing to practice before the IRS, and monetary penalties

• Paid return preparer penalties
  o Referrals for 26 U.S.C. § 6694(b) penalties “mandatory”
  o Referrals for 26 U.S.C. § 6694(b) penalties discretionary
    • Compare Circular 230, § 10.53 (mandatory), with I.R.M., pt. 20.1.6.12.3(6), (8) (Aug. 29, 2019) (discretionary)

• Aiding and abetting an understatement of tax
  o Referrals “mandatory”

• Appraiser penalties under 26 U.S.C. § 6695A
Actions to Enjoin – 26 U.S.C. §§ 7407 and 7408

• Action to enjoin paid return preparers – 26 U.S.C. § 7407
  o Element 1: The tax return preparer has:
    • Engaged in any conduct subject to penalty under Code Section 6694 or 6695, or subject to any criminal penalty provided by this title;
    • Misrepresented his eligibility to practice before the Service or otherwise misrepresented his experience or education as a tax return preparer;
    • Guaranteed the payment of any tax refund or the allowance of any tax credit; or
    • Engaged in any other fraudulent or deceptive conduct which substantially interferes with the proper administration of the internal revenue laws; and
  o Element 2: The injunctive relief is appropriate to prevent the recurrence of such conduct

• Action to enjoin promoters of abusive tax avoidance schemes – 26 U.S.C. § 7408
  o Element 1: The person has taken action (or failed to take action that would give rise to a penalty under Code Section 6700 or 6701 or constitute a violation of Circular 230, and
  o Element 2: Injunctive relief is appropriate to prevent recurrence of the specified conduct
The Age of Promoter Penalties

Table from “The Troubling Rise of Injunction Suits,” Jeffrey A. Neiman and Derick Vollrath, Tax Notes, May 19, 2019
The Age of Promoter Penalties
In sum, the complaint fails to state adequate specific factual allegations to support its conclusory claim that Zak is an “appraiser” per 26 U.S.C. § 6695A. For that reason, defendant Zak’s motion to dismiss Count II as to her only is GRANTED and Count II as it relates to defendant Zak only is DISMISSED without prejudice.

The facts alleged in the complaint lay out a scheme in which parcels of land are knowingly appraised at values far greater than their actual value. The asserted facts in the complaint also clearly allege that the appraisal of the land parcels is perhaps the single most important aspect of the scheme – without the inflated appraisals, the tax returns would not be as substantial, rendering the inducement to investors limp. The Government has adequately pleaded sufficient factual matter to state a claim that Clark’s appraisals represented a “substantial portion” of the tax returns, and therefore he may be liable under section 6694.

Defendant Clark’s motion to dismiss as it pertains to Count III is therefore DENIED. (Doc. 41.)
Thank You!

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