Committee on Civil and Criminal Tax Penalties of the American Bar Association, Section of Taxation

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Important Developments--Civil

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Mr. Benavides was a CPA who established an accounting firm and a second company that provided some accounting firm clients with management and development services, including paying vendors and contractors and reporting expenses. In 2011, Mr. Benavides pled guilty to one count of assisting in the preparation of a false and fraudulent tax return in violation of Section 7206(2). The basis of the plea was that Mr. Benavides used his second company to accept fees from clients, used part of the fees to pay personal expenses of those clients, and reported those personal expenses as business expenses on the clients’ tax returns.

The IRS subsequently initiated a civil audit and assessed tax and fraud penalties under Section 6663(a) against Mr. Benavides and Mrs. Benavides. The assessments were based on adjustments for income diverted from the company, overstated business expenses, and disallowed expenses. The fraud penalties were based on the unreported taxable income and unreported constructive dividends.
The Tax Court analyzed the badges of fraud and determined that Mr. Benavides’ diversion of gross receipts from the company illustrated a pattern of underreporting evidencing an intent to evade tax. In addition, it noted that Mr. Benavides failed to maintain adequate records, there were two sets of books, he pled guilty to a tax-related crime, and he provided inconsistent and implausible explanations for his actions. Mr. Benavides argued that he was negligent – he simply engaged in sloppy bookkeeping and that the diversion of corporate receipts constituted “reasonable compensation” to him (note: he did not report this “reasonable compensation” on his personal return). The Tax Court determined that there was “ample indicia” of fraud to impose the penalty.

With respect to Mrs. Benavides, the Tax Court determined that the IRS did not show that she engaged in fraudulent conduct and did not uphold the penalty against her.

Bellwood v. Comm’r, TC Memo 2019-135 (10/7/2019)

In this case, the Tax Court upheld accuracy-related substantial understatement penalties against a pilot and his wife, rejecting their reasonable cause defense. The understatement involved unsubstantiated deductions and improper exclusion of foreign income for his work for a U.S. company in Saudi Arabia. The taxpayers argued that they had reasonably relied on tax preparation software (TurboTax) for the reporting. The Tax Court disagreed, noting that even if the software was considered a “competent professional” for purposes of reliance, the taxpayer failed to properly enter correct information into the software program. The Tax Court referred to its prior holdings that “[t]ax preparation software such as TurboTax is only as good as the information the taxpayer puts into it. The misuse of tax preparation software, even if unintentional or accidental, is no defense to accuracy-related penalties under section 6662.”


The Tax Court issued its latest ruling on the 280E issue for state-legal marijuana businesses in Northern California Small Business Assistants. Here, the Tax Court held that section 280E, which prohibits marijuana businesses from claiming federal deductions, does not violate the Eighth Amendment of the Constitution, prohibiting excessive fines or penalties. After IRS disallowed the cannabis company’s $1.5 million in business deductions, the taxpayer challenged the constitutionality of section 280E.

Prior decisions have held that 280E does not violate the Constitution, and the Tax Court’s decision added to that precedent. The Tax Court disagreed with the taxpayer’s argument that 280E operates as a penalty by constituting a tax on gross receipts, and concluded that 280E does not violate the Eighth Amendment.

The case is notable due to the dissenting opinions published. Judge Gustafson authored a dissent, opining that he believed section 280E violated the Sixteenth Amendment by unconstitutionally exceeding Congress’s power to impose an income tax. Judge Copeland agreed with Judge Gustafson, and also wrote a separate dissent concluding that 280E is a penalty and suggesting that further analysis is necessarily required as to whether 280E violates the Eighth Amendment.

In this case, petitioner in a refund suit challenged the computation of Section 6700(a) penalties assessed against him. The court previously determined that Mr. Tarpey was liable for penalties assessed against him under Section 6700, and the parties filed cross-motions for summary judgment based on the amount of penalties to be assessed. The penalties were imposed based on Mr. Tarpey’s involvement facilitating the donation of timeshares and report charitable deductions based on the donation.

Section 6700 provides for a 50% penalty on the gross income derived from such activity by the person on which the penalty is imposed. The parties challenged and the court considered the definition of “activity” and whether activity encompassed all activities in Tarpey’s business or whether it was more narrowly construed to include only his activities in performing the inflated appraisals. In other words, should the penalty should be computed based on all of Tarpey’s activities or based on a limited category of income?

The court held that the “activity” generating the penalty included the whole arrangement – soliciting the donations, appraising them, etc. The court found that the language of the statute indicated that the “activity” encompassed more than the conduct of actually making a false or fraudulent statement, broadly interpreting what could be included in the penalty computation.

Nevertheless, the Court found the IRS did not prove the penalty amount it asserted. The IRS’s Form 4340, which is typically entitled to a presumption of correctness, was deemed insufficient, because the IRS’s testimony, provided in affidavits, offered contradictory computations. As such, the Court declined to grant summary judgment, instead deciding that the IRS must present “a thorough and accurate assessment of Tarpey’s penalty amount” in order for the Court to make a determination as to the amount of the penalty.


This case involved a CPA/investment banker’s quest for administrative costs under Section 7430. The Petitioner challenged penalties assessed against him under Section 6707, for an alleged failure to disclose certain tax shelter transactions. When IRS Exam informed him of its intent to assess $1,608,126 in penalties under Section 6707, Petitioner immediately offered to settle the case for $10,000. When his offer was rejected, he filed a protest, requesting his case be heard by Appeals. At Appeals, he resolved the case for $169,855.

After the settlement, Petitioner submitted to the IRS a request for “reasonable administrative costs” under section 7430(a)(1), claiming that he was the “prevailing party.” The Tax Court disagreed, reasoning that, because IRS settled before any deficiency or decision, the IRS did not take a “position” contrary to Petitioner’s position. Thus, under Section 7430(c)(7), Petitioner was not prevailing party. The Tax Court agreed, noting that it did not matter that the Section 6707 penalty was not subject to deficiency proceedings.
In December 2018, the Department of Justice filed a complaint to enjoin defendants, alleged promoters, from organizing, promoting or selling an allegedly abusive conservation easement syndication tax scheme. Conservation easements are legal agreements “between a landowner and another party, generally a land trust or government agency, that permanently restricts the development and/or use of land with the purpose of achieving certain conservation or preservation goals.” A landowner designates a part of his or her property to become a conservation easement, preventing future development, in exchange for a tax benefit based on the value of the land. In certain circumstances, the landowner’s income is not great enough to utilize the full benefit of the tax credit. Here, at a very high level, the defendants were allegedly forming pass-through limited liability companies to hold ownership of the parcel of land, selling membership interests in the LLC to wealthy individuals who could benefit from the tax benefit, and passing-through the tax benefits to those individuals.

Among other counts, the Government alleged that defendants’ conservation easements were a “syndication scheme”, in violation of Section 6700 of the tax code. The defendants each filed a motion to dismiss, arguing that the Government failed to meet the heightened pleading requirement set forth in F.R.Civ.P. 9(b). Rule 9(b) requires that a plaintiff pleading a fraud claim must allege “(1) the precise statements, documents, or misrepresentations made; (2) the time and place of and person responsible for the statement; (3) the content and manner in which the statements misled the Plaintiffs; and (4) what the Defendants gained by the alleged fraud.”

In its decision, published in December 2019, the district court noted that the parties in the case do not dispute that the defendants engaged in certain activities, they dispute whether those activities were lawful. The defendants argued that the complaint alleged 90 instances of fraud but only described three and therefore failed to meet the requirements of Rule 9(b). The court concluded that the three examples adequately apprised the defendants of the type of conduct that made up the alleged illegality and denied defendants’ motion to dismiss.

One defendant, a conservation manager, also presented in her motion to dismiss a challenge to a claim for penalties assessed under Section 6695(A), arguing that section only applies to individuals who prepare appraisals. In the complaint, the Government alleged that the Defendant “assisted in appraising the conservation easements[, and] in making the highest and best use determinations[.]” This defendant argued that the Government failed to allege that she prepared the appraisal and that Section 6695(A) does not extend to individuals who merely assist. The defendant pointed to several sections within the Code that specifically reference “assistance” and argued that, if Congress had intended Section 6695(A) to apply to those who assist, it would have specifically stated that. The Court agreed and dismissed the count against her.

Another defendant, who provided valuation services, presented a motion to dismiss a claim for penalties assessed under Section 6694, arguing that he was not a “return preparer”. The defendant agreed that he was aware his valuation would be used in the preparation of a tax return but did not prepare the return or a substantial portion of the return for compensation. The Government argued that the valuation was a “substantial portion” of the tax return and therefore
Section 6694 applies. The Court noted that the allegedly overinflated appraisals of the land value was the most important part of the tax return and scheme, and agreed with the Government’s position that defendant’s appraisals represented a “substantial portion” of the tax return such that the defendant could be held liable under Section 6694.


We originally chose to include this case based on the District of New Jersey’s opinion published in October 2019. The District Court published a superseding memorandum and opinion on January 7, 2020, to apply a de novo standard of review (the original opinion used an arbitrary and capricious standard of review) to determine whether the estate established reasonable cause and not willful neglect in failing to timely file an estate tax return. Lucky for the estate, the District Court determined the estate demonstrated reasonable cause under either standard.

Under the tax code, an estate has nine months from the date of death to file an estate tax return. Agnes R. Skeba died June 10, 2013 and counsel for her estate filed an “Application for Extension of Time to File a Return and/or Pay Estate… Taxes”, explanation of reasons for the application, and a partial payment of tax ($725,000) on March 6, 2014, four days before the return was due on March 10, 2014. Counsel reported to the IRS that the estate was paying all its liquid assets to federal and state taxing authorities and that the estate would need time to appraise the property to determine the tax liability and mortgage or sell illiquid assets to pay the remainder of the tax due.

Twelve days later, the estate remitted a second payment of $2,745,000 to the IRS. In June 2014, the IRS approved the estate’s request for an extension to file the return until September 2014. In July 2014, the IRS approved the estate’s request for an extension of time to pay tax until September 2014. Neither letter acknowledged the receipt of estimated taxes and both informed the estate that a further extension could be requested.

The estate filed its federal estate tax return in June 2015. The return reported a tax liability of $2,528,838, payments of $3,470,000 and an overpayment of $941,162. In August 2015, the IRS sent a notice assessing the estate a failure to file penalty of $450,959.50 based on an “unpaid amount” of $1,803,838, which was calculated as the tax liability less the initial payment of $725,000. In August 2015, counsel for the estate submitted a request for abatement of penalties for reasonable case based on reliance on IRS representatives’ oral advice, delays in filing based on litigation concerning the estate, and serious illness of the estate’s litigation counsel. The IRS denied the request for penalty abatement and the estate’s accountant prepared an appeal based on the reasons previously articulated and another argument that he believed the IRS did not take into account the second estimated tax payment and the extension that was timely filed.

The IRS argued that the last day for payment was March 10, 2014 (original due date of the estate tax return) under Section 6151. The court disagreed, holding that under Section 6651, the date that penalties will be assessed should consider any extensions. Thus, penalties should not have been measured until September 2014. In addition, the court noted that the health of the
executor, the estate’s litigation counsel being diagnosed with cancer, and difficulty in securing necessary valuations and appraisals for the various real estate assets, was enough to demonstrate reasonable cause to abate the penalties.

**Revenue Procedure 2019-42**

The IRS asserts a penalty under Section 6662 equal to 20% of the portion of tax that is underpaid for the tax year at issue, including underpayments attributable to a substantial understatement of tax. A “substantial understatement of tax” exists when the amount of an understatement exceeds the lesser of (a) 10% of the tax that should have been shown on the return or (b) $5,000 for individuals or the lesser of 10% of the tax that should have been shown on the return (or $10,000, if greater) or $10M for corporations. The penalty increases to 40% for the following situations: (a) gross valuation misstatements under Section 6662(h); (b) nondisclosed transactions without economic substance under Section 6662(i); undisclosed foreign financial asset understatements under Section 6662(i).

In December 2019, the IRS updated its procedures and requirements concerning adequate disclosure for purposes of reducing an accuracy-related penalty under Section 6662(d) and/or avoiding a tax return preparer penalty under Section 6694(a). All transactions (1) must have a reasonable basis as defined by Treas. Reg. § 1.6662-3(b)(3), (2) may not be a tax shelter item as defined under Section 6662(d)(2)(C)(ii); and (3) must be properly substantiated and supported by books and records.

The Revenue Procedure requires a taxpayer to furnish all required information identified on the applicable form and/or instructions. In addition, the information provided must be “verifiable”. “[A] number is verifiable if, on audit, the taxpayer can prove the origin of the amount (even if that number is not ultimately accepted by the Service) and the taxpayer can show good faith in entering that number on the applicable form.”

When a taxpayer is disclosing information in a section that does not have a clear identifier on the form (i.e., reported on a line under “other expenses” versus reported on a line titled “travel”), the taxpayer must identify the category (for example, “bad debt”).

Any transactions between related parties must be disclosed on a Form 8275 or Form 8275-R.

Disclosure as a defense to a penalty against a return preparer under Section 6694(a) will not apply to positions concerning tax shelters or reportable transactions.