

## First-time abatement: Procedure and case law updates

This discussion summarizes recent developments in the IRS's application of its first-time abatement (FTA) penalty waiver policies as the Service continues to modernize its systems to apply abatement procedures consistently. The IRS recently released Office of Chief Counsel memorandum PMTA-2018-2, which sets forth how the IRS Office of Servicewide Penalties (OSP) has undertaken a project to automate the FTA process. While the Internal Revenue Manual (IRM) sets forth the IRS's policies regarding FTAs, recent memoranda released by the IRS, along with the Tax Court's recent rulings on FTAs, provide helpful perspective on how the IRS may apply this relief now and in the future.

### FTA background

Since 2001, the IRS has applied FTAs to provide relief from delinquency penalties for otherwise compliant taxpayers. Under these policies, taxpayers may receive relief if they establish that the taxpayer (1) has filed, or filed a valid extension for, all currently due returns; (2) has paid or arranged to pay any tax currently due; and (3) has not received an applicable delinquency penalty for the return in the three prior years (or was not previously required to file such a return) (IRM §§20.1.1.3.3.2.1(2) and (4)).

The IRS updated its FTA policies and the IRM following a 2012 report by the Treasury Inspector General for Tax Administration (TIGTA), *Penalty Abatement Procedures Should be Applied Consistently to All Taxpayers and Should Encourage Voluntary Compliance*, Rep't No. 2012-40-113. TIGTA concluded,

in part, that the IRS had failed to consistently apply its FTA policies and recommended that the Service better inform taxpayers of the ability to receive FTA relief. The TIGTA report also criticized the IRS, finding that the Service's Reasonable Cause Assistant tool it used to help employees process penalty abatement requests had made incorrect determinations in 89% of the cases sampled.

### Automation of FTAs

While FTAs have been available to taxpayers for well over a decade, the IRS has historically provided relief only after a taxpayer affirmatively requested an FTA or abatement under reasonable cause. Under its proposed policy set forth in the IRS's memorandum, the Service will grant all taxpayers who meet the FTA requirements an FTA waiver. The IRS would achieve this result by mechanically "suppressing" the applicable penalties in the taxpayer's master file. As set forth in PMTA-2018-2, the OSP estimates that this automation step will increase the number of waivers from 350,000 to 1.7 million annually, with a dollar increase in penalties abated from \$578 million to \$848 million per year. Citing the commissioner's discretion to administer and enforce penalties to encourage voluntary compliance, the memorandum concludes that the commissioner may choose not to impose the penalty on a class of taxpayers (i.e., those who qualify for an FTA) to enhance overall tax compliance.

While the memorandum focuses on abatement of delinquency penalties for the identified class of otherwise compliant taxpayers, another recent IRS memorandum emphasized that the IRS may use the FTA process where the penalty was not assessed but rather was considered for a taxpayer in an examination. Specifically, Chief Counsel Advice (CCA) 201414017 stated that an FTA is a policy decision of the IRS and it would be "a waste of resources

for the penalty to have to be assessed, and then protested, and then abated, if the FTA was appropriate." Further procedures for or automation of FTA application in examinations would also better reconcile the IRS's FTA policies in post-assessment cases and the IRM's requirement that IRS employees not improperly assert delinquency penalties in the first instance as a bargaining chip in examinations (IRM §20.1.1.2.3.1).

### Tax Court's consideration of FTAs

In *Laidlaw*, T.C. Memo. 2017-167, the Tax Court considered the taxpayers' arguments that the IRS erred by not waiving late-filing penalties under the FTA policies. The taxpayers failed to convince the court that their preparer timely filed their tax return extension, but they also argued that they were otherwise compliant in the prior three years and that the IRS should have granted FTA relief. The IRS countered that the taxpayers did not request abatement; that the FTA procedures were administrative, not judicial; and that there technically was no assessment of the late-filing penalties.

The Tax Court rejected the taxpayers' arguments, but in doing so it noted that the IRM then placed the FTA policy under the "Reasonable Cause Assistant" category in IRM Section 20.1.1.3.6. The Tax Court then concluded that because the taxpayers did not argue the existence of reasonable cause, and since there was no evidence that the taxpayers requested (or were denied) FTA relief, there was no basis in the record upon which to find for them.

### FTA automation and IRM developments since *Laidlaw*

Since *Laidlaw*, two developments may affect the court's future analysis of the case or the frequency with which it considers other such cases. First, on Nov. 21, 2017, the IRS revised the IRM, moving the FTA policy to a stand-alone section for administrative waivers under IRM

Section 20.1.1.3.3.2.1, instead of under the "Reasonable Cause Assistant" content in IRM Section 20.1.1.3.6, as the Tax Court emphasized. While an FTA is still clearly an administrative waiver, its separate placement in the IRM may yield a different result with the IRS and in Tax Court if the additional facts are properly included in the record. Second, the IRS's shift to automating the FTA process, along with its continued policy of not imposing penalties for negotiating strength, may result in fewer court cases litigating delinquency penalties.

The IRS's efforts to review automation of FTAs, together with other potential steps to modernize its procedures to apply penalties consistently and fairly, may permit the IRS to focus more resources on serially noncompliant taxpayers than on taxpayers who make an occasional mistake.

From Cory Stigile, CPA, J.D., LL.M., Beverly Hills, Calif. ■

## Contributors

*Dan Wise*, CPA, is a National Tax director and head of Tax Risk for CohnReznick LLP. *Matthew Cooper*, J.D., is a senior manager in the Ernst & Young LLP Tax Controversy group, advising on tax controversy matters, and was previously special counsel to the associate chief counsel (Procedure & Administration) in the IRS Office of Chief Counsel. *Cory Stigile*, CPA, J.D., LL.M., is a principal with Hochman, Salkin, Rettig, Toscher & Perez PC in Beverly Hills, Calif. *Valrie Chambers* is an associate professor of accounting at Stetson University in Celebration, Fla. Mr. Wise, Mr. Cooper, and Mr. Stigile are members of the AICPA Tax Practice & Procedures Committee. For more information about this column, contact [thetaxadviser@aicpa.org](mailto:thetaxadviser@aicpa.org).