IRS Penalty Abatement Case Study

CLIENT A, a woman in her late 40's was recently widowed. Prior to passing away, it was CLIENT A's husband's "responsibility" to maintain the couple's finances as well as to ensure that their tax returns were prepared and filed by their CPA. Notice that the word "responsibility" is in quotation marks. This is because while the couple determined that this would be the husband's job, the IRS and State considered both to be equally responsible.

Shortly after the passing of her husband, it was brought to CLIENT A's attention that the finances her husband had been supposedly managing were not as organized as well as they should have been. In addition CLIENT A's husband had not yet filed their latest year's tax return prior to passing away, and to this fact she was unaware. Once she determined that the return had not been filed. CLIENT A was devastated to learn that in addition to having to deal with the fact that her husband passed away, she now had a tax problem resulting in taxes owing including penalties of more than $50,000.

Having further researched the details of the situation, we determined that there was a miscommunication between CLIENT A and her CPA which caused the return to be both late filed and late paid.

We were able to work with CLIENT A's CPA to obtain documentation substantiating the fact that the miscommunication caused the late filing and subsequently the late payment. With the substantiation from the CPA, we requested that the IRS abate the penalties due to "reasonable cause" and laid out the legal and factual basis for the IRS to fully abate the penalties.

"Reasonable cause relief is generally granted when the taxpayer exercises ordinary business care and prudence in determining their tax obligations but is unable to comply with those obligations."

Essentially, this means something beyond the control of the taxpayer has occurred that has caused him not to file timely. The taxpayer took reasonable steps to rectify the situation as soon as he was informed by his CPA of the communication failure.

In this case, the taxpayer's CPA and other professionals in full possession of the facts mistakenly assumed facts not in evidence, while the taxpayer had no reason to have knowledge to the contrary. Had the taxpayer's CPA instructed the taxpayer that the e-filed return was rejected by the IRS, the taxpayer would have found out why and corrected the error immediately. In fact, the taxpayer promptly caused the 2010 Form 1040 to be prepared and filed immediately after her CPA belatedly informed her that the e-filed return was rejected.

The Internal Revenue Manual says that any reason will be accepted as reasonable cause if it can be

able to comply with their tax obligations.

A penalty can be abated when the taxpayer can show reasonable cause for failing to comply with a particular requirement. Although there is no specific definition of Reasonable cause, Regulations Section 301.6651-1(c)(1) contains the following basic language relating thereto:

If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to a reasonable cause. A failure to pay will be considered to be due to reasonable cause to the extent that the taxpayer has made a satisfactory showing that she exercised ordinary business care and prudence in providing for payment of her tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship if she paid on the due date.

The IRS agreed with our analysis and abated all $50,000+ in penalties. We then submitted a request for abatement of penalties to the State of California Franchise Tax Board, citing the IRS's abatement as precedence, and were successful once again.