

Using ‘Reasonable Cause’ to Avoid IRS Penalties

BY ROBERT W. WOOD

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Taxpayers ask to have IRS penalties forgiven for many reasons. One of the most common, and most misunderstood, is the assertion that the taxpayer had “reasonable cause” for the failure to file a return or pay tax that is due. “Reasonable cause” might sound like a simple phrase, but even if you think your cause is reasonable, the IRS may not agree. How the IRS evaluates reasonable cause depends on which penalty has been assessed and how you behaved. On top of reasonable cause, some penalty defenses involve an absence of willful neglect. Isn’t that proving a negative? Yes, and guess who wins in a tax penalty stalemate? The IRS, of course.

The IRS applies reasonableness on a case-by-case basis, which sometimes leads to inconsistent results. However, you bear the burden of substantiating your claim of reasonable cause. The stakes can be big, from 20 percent to a whopping 75 percent of your tax bill. The tax code is chock-full of penalty provisions, so you always want to behave reasonably and in good faith.

TAX RETURN REPORTING

According to the IRS, the most significant factors in determining whether you have reasonable cause and acted in good faith are your efforts to report your proper tax liability. Were you careful in doing your best to report the right amount?

For example, suppose that you report the amount from an erroneous Form 1099, but you didn’t actually *know* that the Form 1099 was wrong. You *think* the Form 1099 shows the total you were paid, but under audit you discover that the Form 1099 reported less than you actually received. That could happen to anyone. We all rely on Form 1099 data, so reasonable cause may apply if you just picked up a reported number and reasonably assumed it was correct.

But what if you were paid \$300,000, and the Form 1099 said you received \$300?

It might be harder to say you reasonably relied on that number as being correct and reported it, compared to an error where the inaccurate Form 1099 said you received \$285,000.

Still, how you behave and what you did may be reasonable, even with a big error. For example, an isolated computation or transposi-

tion error may be consistent with reasonable cause and a good faith effort. A mistake or two can often be explained, even if it is clear in the end that you were just plain wrong. However, if you have a dozen of these errors on your return, it becomes less likely that the IRS will understand and let you off the penalty hook.

RELIANCE ON A TAX ADVISER

Other factors the IRS considers include the taxpayer’s experience, knowledge, education, and reliance on the advice of a tax adviser. If you do use a tax adviser, you must provide that person with all of the necessary information to evaluate your tax matter. In other words, cherry-picking what you tell your tax adviser to get the answer you want to hear is not reasonable.

The IRS says that the adviser must have knowledge and expertise related to the tax matter. If you have a complex corporate tax problem and you go to an individual income tax adviser who does not handle corporate tax matters, it might not be reasonable for you to rely on that person, no matter how faithfully you follow his or her advice.

RELIANCE ON ADVICE FROM THE IRS

Some mistakes and circumstances are beyond your control. However, the IRS also asks whether you could have foreseen or anticipated the event that caused the problem in the first place. How about relying on tax advice from the IRS, isn’t that always reasonable? Not necessarily. This can be a

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surprisingly touchy issue, particularly in the case of oral advice.

Oral advice usually isn't worth the paper it's not printed on. If you point to something the IRS told you in writing, the IRS evaluates the information and determines if the advice was in response to a specific request and related to the facts contained in that request. The IRS also wants to know if you *actually relied* on its advice.

IN WRITING

Like just about everything else with the IRS, you almost always should lay it out in writing. In fact, in many cases, the tax regulations actually *require* the taxpayer's request for waiver of the penalty to be in writing and even signed under penalties of perjury.¹

ORDINARY BUSINESS CARE

The IRS will consider any reason that establishes that you used all ordinary business care and prudence to meet your tax obligations but were nevertheless unable to do so. Ordinary business care and prudence means taking the degree of care that a reasonably prudent person would exercise, while still being unable to comply with the law.

Your effort to report the proper tax liability is the most important factor in determining reasonable cause. The IRS considers all facts and circumstances, and reviews all available information such as the taxpayer's reason, compliance history, length of time, and circumstances beyond the taxpayer's control. You might assume that this is just about the tax year involved. However, the IRS often looks at the three previous tax years for your payment patterns and compliance history. If you are hit with the same penalty each year, you may not be exercising ordinary business care. On the other hand, if this is your first incidence of noncompliance, the IRS will consider that, along with the other reasons and circumstances you provide.

Some penalty sections also require that you act in good faith, or that your failure to comply was not due to willful neglect. You want to show how your facts and your conduct meet all the required tests.

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WHAT ISN'T REASONABLE

Taxes are complex, but some errors aren't reasonable. For example, the IRS says you generally do not have reasonable cause if the penalty relates to the late filing of a tax return or late payment of a tax obligation. Saying that you *thought* tax returns were due May 15, not April 15²—even if a tax professional told you that—isn't likely to save you from penalties.

Also, saying that your accountant had your return, you told him to file it, and he forgot? The IRS says *everyone* is responsible for timely filing taxes, and for paying them, and those duties cannot be delegated. So even if you rely on accountants, bookkeepers, or attorneys, you cannot delegate responsibility to timely file tax returns and timely pay tax obligations. On the other hand, things like the unavailability of records or a change to the law that you could not reasonably have been expected to know might be forgiven.

In some cases, you can even seek penalty relief due to a lack of knowledge of the law. Relevant factors include your education, whether you have been subject to the tax before, whether you have been penalized before, the complexity of the tax issue, and recent changes in the tax law or forms.

How about forgetfulness as a basis for reasonable cause? Nope, the IRS says forgetfulness indicates a *lack* of reasonable cause.

CONCLUSION

Avoiding penalties with the IRS is a vast subject. If you or a client are being penalized, analyze the facts from a common sense perspective and look into the large body of governing tax law. And if the dollars are significant to your pocketbook, get some professional advice. **BN**

NOTES

1. See Treas. Reg. 301.6651-1(c)(1) and 301.6724-1(m).
2. Of course, May 17 is the deadline this year for filing 2020 tax returns.





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<p>Surowiecki v. Hat Island Community Association, ___ P.3d ___, 2020 WL 5630052 (2020) (reversal of trial court refusal to address whether HOA assessments were equitable)</p> <p>Bao Xuyen Le v. Molina, 810 Fed. Appx. 550 (9th Cir. 2020) (affirmed rejection of officer qualified immunity in police shooting case)</p> <p>Nelson v. Thurston County, 2020 WL 2838608 (2020) (denying qualified immunity to a police officer who shot a citizen in the back)</p> <p>Messenger v. Whitemarsh, 462 P.3d 861 (2020) (recognizing that a doctor who has sex with a patient the doctor treats for mental health issues can be sued for malpractice)</p> <p>Plein v. USAA Cas. Ins. Co.; Sterling Group, 195 Wn.2d 677, 463 P.3d 728 (2020) (RPC 1.9 interpretation)</p> <p>Judges of Benton and Franklin Counties v. Killian, 195 Wn.2d 350, 49 P.3d 1082 (2020) (amicus brief on county clerk authority)</p>	<p>Meyers, et al. v. Ferndale School District, 12 Wn. App. 2d 254, 457 P.3d 483 (2020) (district responsible for student killed by driver who ran off road striking him during improper off campus walk)</p> <p>Coogan v. NAPA, 12 Wn. App. 2d 1021 (2020) (overturning \$81.5 million judgment)</p> <p>Habu/Chinn v. Topacio, et al., 12 Wn. App. 2d 1006 (2020) (reversing enforcement of CR 2A agreement)</p> <p>Hendrickson v. Hempzen Enterprises; Sotebeer; Davenport; Ware, et al. 11 Wn. App. 2d 1047 (2019) (vacating default judgment entered against commercial tenants)</p> <p>Volkert v. Fairbank Constr. Co. and Ziegler, 8 Wn. App. 2d 399, 438 P.3d 1203 (2019) (Uniform Health Care Info. Act foreclosed disclosure of all experts' past CR 35 exam reports)</p> <p>Adamson v. Port of Bellingham, 192 Wn.2d 178, 438 P.3d 522 (2019); 923 F.3d 728 (2019) (recognizing liability of Port as premises owner)</p>
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