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THE IRS IS COMING: ARE YOU AND YOUR CLIENTS READY?

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THE IRS IS COMING: ARE YOU AND YOUR CLIENTS READY?

I.

Introduction

1. The IRS is authorized by Congress to determine and collect the tax liability of all persons. To accomplish these goals, Congress gave the IRS the following broad powers:
 - a. To examine any books, papers, or other relevant data;
 - b. To take testimony under oath; and
 - c. To summon a taxpayer, or any other person, to appear before the IRS, produce books, papers, records, or other data and give testimony under oath.
2. The IRS uses these tools for obtaining information during an examination of a tax return, collection of delinquent tax or in a criminal investigation.

II.

IRS Enforcement Focus

1. High Income Taxpayers
2. Employee Retention Credit
3. Malta Pension Plan
4. Puerto Rico Act 20/22/60
5. ESOPs
6. Monetized Installment Sales
7. Micro-Captive Insurance
8. Syndicated Conservation Easements

III.

IRS Examinations

1. Most IRS examinations are conducted on an informal basis using interviews and requests for documents. The extent of the IRS request for information depends on the type of examination that is being conducted.
2. In a correspondence or office examination the IRS generally asks for documents and other information to support the information on the tax return. If the taxpayer fails to respond or does not provide the requested information, the examiner typically disallows the questioned items, makes appropriate adjustments and sends the taxpayer a 30-day letter or Notice of Deficiency. It is rare to see a summons issued in a correspondence or office examination.
3. In a field audit, the IRS requests are generally by an Information Document Request (IDR), are more extensive and the examination is conducted at the taxpayer's place of business, or another agreed upon location. If the taxpayer fails to provide the requested information, the IRS is more likely to issue a summons.

IV.
Taxpayer Rights

1. Explanation of the audit process;
2. Reasonable time and place of the examination;
3. Right to representation;
4. Right to confidentiality;
5. Right not to be interviewed, except through a summons;
6. Right to be notified of third-party contacts;
7. Right to record any interview by the IRS;
8. Freedom from repeat examinations; and
9. A right to present witnesses and evidence.

V.
Statute of Limitations

1. Taxes and penalties are generally required to be assessed by the IRS within three years after a taxpayer's return is filed.
2. In the case of a false or fraudulent return filed with the intent to evade tax, or if the taxpayer fails to file a required return, the tax may be assessed at any time.
3. Where the original return, as filed, omitted gross income in an amount exceeding 25% of the gross income that was stated on the return, the three-year statute of limitations is extended to six years.
4. A taxpayer can also extend the statute of limitations by agreement.
5. Exception to the three-year period of limitations under §6501(c)(8) for failure to provide information about cross-border transactions or foreign assets.
 - a. Statute of limitations period for possible assessment of additional taxes and penalties related to the taxpayer's income taxes remains open indefinitely.
 - b. Applicable to the entire income tax return – not just the tax consequences related to the information required under the relevant foreign information reporting provision.
 - c. If the failure to file the information return is due to reasonable cause, the extended limitations period applies only to items on, or items related to the late filed information return.
 - d. Relevant information returns include Form 8621, Form 5471, Form 8865, Form 8858, Form 5472, Form 926, Form 8938, and Form 3520-A.
6. The statute of limitations is tolled if:
 - a. The taxpayer files bankruptcy;
 - b. The IRS issues a notice of deficiency; or
 - c. The taxpayer institutes or intervenes in a proceeding with respect to the enforcement of a third-party record keeper summons.

VI.
Information Document Request (IDR)

1. An IDR is used by the IRS when there are voluminous records to be examined or the IRS determines it should keep a record of its requests.
 - a. Relatively informal and negotiable.
 - b. The IRS cannot require a taxpayer to create documents. However, in some cases a schedule may help the agent complete the examination on a more timely basis.
 - c. It is not advisable to let the IRS keep originals documents.
 - d. If the IRS agent wants copies of a document for its file, keep a record of what is requested and keep a copy for your file. Consider date stamping documents.
 - e. You can always supplement the response with newly discovered documents.
 - f. If the taxpayer does not respond or refuses to provide documents the IRS can make the appropriate adjustment or issue a summons.
2. In 2014, the IRS Large Business and International Division issued a directive regarding procedures for issuance and enforcement of IDRs.
 - a. The directive emphasized communication and cooperation between the exam team and the taxpayer to avoid miscommunications regarding:
 - i. The issue that is the subject matter of the IDR;
 - ii. What information is necessary to evaluate the issue and why;
 - iii. What information the taxpayer has and how long it will take to provide it; and
 - iv. How long it will take the IRS to review the information for completeness and respond to the taxpayer.
 - b. The directive includes the requirements for the issuance of a summons and procedures for enforcement.
3. IDR Enforcement Process-A Three Step Enforcement Process.
 - a. The IRS Examiner will first issue a “Delinquency Notice” (Letter 5077). The IRS Examiner is expected to issue the Delinquency Notice within 10 days of the IDR response date and should give the Taxpayer no more than 15 days to comply. However, the IRS has discretion to extend the 15-day deadline for responding if the circumstances warrant such an extension.
 - b. If the Taxpayer fails to comply with the deadline in the Delinquency Notice, the IRS will issue a “Pre-Summons Letter” (Letter 5078). The Pre-Summons Letter will generally be sent within 14 days of the deadline in the Delinquency Notice. The Pre-Summons Letter should allow the Taxpayer an additional 10 calendar days from the date of the letter to comply.
 - c. If the Taxpayer fails to comply with the Pre-Summons Letter, the Examiner is to issue a summons.

VII.
Formal Document Request (FDR)

1. If the IRS issues an IDR requesting foreign-based documents and the taxpayer fails to produce the requested documents, the IRS may issue a Formal Document Request (FDR) pursuant to IRC Section 982.

2. If a taxpayer fails to substantially comply with an FDR within 90 days, the taxpayer may be prohibited from later introducing into evidence any documents covered by the request in any subsequent civil proceeding with the IRS.
3. The taxpayer may file an action to quash the FDR, however, care should be taken before doing so. In response to an action to quash an FDR, the IRS can file to enforce the FDR similar to a summons. If the court orders compliance, a taxpayer who fails to comply can be found in contempt of court and subject to fines or jail until compliance.

VIII.

Taxpayer Interviews

1. An interview is typically required in all examinations for background information such as the taxpayer's financial history, business operations, etc.
2. The place and time of any interview can be negotiated but must be convenient to the taxpayer.
3. Options for responding:
 - a. Agree to the interview.
 - b. Provide documents or written answers to anticipated questions in lieu of an interview.
 - c. Request the examiner provide a list of the questions and provide written responses.
 - d. Negotiate the scope of the interview.
 - e. Ask the examiner to delay the interview until after review of the documents.
 - f. Refuse to comply and force the IRS to issue a summons.

IX.

Business Site Visits

1. In business examinations it is not unusual for the examiner to request a tour of the business.
2. Likewise, in hobby-loss examinations the examiner will usually want to visit the business location.
3. Depending on the examiner, the site visit may last a few minutes or hours.
4. One alternative to consider is providing a videotape tour of the business.
5. If there is to be a site visit, it is very important it be at the convenience of the taxpayer and not disrupt the business operations.

X.

Summons

1. Pursuant to IRC Section 7602(a), the IRS may use its summons power, for both civil and criminal purposes, to:
 - a. Ascertain the correctness of a return;
 - b. Gather the information necessary to make a return where none has been filed;
 - c. Determine the liability of any transferee or fiduciary regarding any internal revenue tax; or
 - d. Collect any internal revenue liability.

2. A taxpayer may base a challenge to the validity of a summons either on a claim that the summons exceeds the statutory limits of the IRS's summons power or that the summons constitutes an abuse of process.
3. A summons is not a subpoena.
 - a. A summons is an administrative request for documentation or testimony issued by an agency. Virtually all agencies have some variation on the summons: EPA, SEC, and IRS. Summons are always used in civil matters.
 - b. A subpoena is issued by a court and noncompliance can result in contempt-of-court proceedings which can include serious consequences. Subpoenas issued by the IRS are either criminal or civil in a trial type setting.
4. Section 7210 prescribes one (1) year in prison and a \$1,000 fine for an individual who "neglects to appear or to produce."
 - a. There has been a single prosecution under this statute about 60 years ago. More importantly, there have been a series of Supreme Court decisions making it clear that a summoned individual has the obligation to physically appear at the appointed time and place but is immunized from prosecution if they interpose "good faith objections."
 - b. The IRS prominently prints 7210 on the Summons' form, but neglects to mention the case law.
5. The IRS has a very low bar to meet for purposes of enforcement of a summons. The requirements are sometimes referred to as the *Powell* requirements:
 - a. The examination relating to the summons is conducted pursuant to a legitimate purpose;
 - b. The summons seeks information that may be relevant to that purpose;
 - c. The IRS is not already in possession of that information; and
 - d. The administrative steps required by the IRC have been followed.
6. A party may object to the summons.
 - a. Procedural defects in the issuance of the summons.
 - b. Failure to satisfy one or more of the Powell requirements.
 - c. The summons was issued after a criminal referral.
 - d. The information covered by the summons is subject to one or more privileges.
7. The IRS can issue a summons to a third-party record keeper.
 - a. The IRS must give the taxpayer notice within three (3) days of serving the summons on a third party but not less than 23 days before the compliance date.
 - b. The notice must include a copy of the summons and an explanation of the taxpayer's right of intervention.
 - c. The taxpayer may move to quash the summons in Federal Court within 20 days after the summons was served or mailed.
8. Although the issuance and /or enforcement of a summons to a taxpayer has no effect on the statute of limitations, if a taxpayer files an action to quash a third-party record keeper summons the status of limitations will be tolled.
9. IRC Section 7609(f) provides for a special type of summons called a John Doe summons.
 - a. Unlike other IRS summonses, a John Doe summons does not list the name of the taxpayer under investigation because the taxpayer is unknown to the IRS.
 - b. Unlike other IRS summons which can be issued by the IRS virtually at will, a John Doe summons must be approved by a federal district court judge. The judge may approve only if:

- i. The summons relates to the investigation of a particular person or ascertainable group or class of persons;
- ii. There is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of the tax law; and
- iii. The information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources.

XI.

Tips for Working with the IRS Examiner

Through the years, I have developed or adopted, from other practitioners, suggestions about dealing with the IRS in exams. The suggestions below are generalizations, to which there are substantial exceptions. Practitioners that deal with the IRS are bound not only by their individual professional ethics but also by Circular 230. It is important to recognize the significance and import of those rules and to apply not only their letter but also their spirit. The goal of any representative is to get a client out of an IRS examination as quickly as possible.

1. **Be Prepared.** You should meaningfully review all the records and information, so you know the client's tax return, transactions, and documents better than the IRS agent. You also should identify, in advance, any potential issues on the tax return and be prepared to respond.
 - a. **Verify taxpayer factual claims, especially those claims that appear to be too good to be true.** You do not want to lose the trust of the IRS agent and it can be embarrassing and frustrating to make a great argument only to be shown that the facts on which the argument is based are not true.
 - b. **Review the documents and look for any gaps or inconsistencies.** Be prepared to explain any issues with the documents.
 - c. **Always calculate the dollar effect of any given issue or concession.** This is especially true where an issue can impact multiple tax returns or tax years.
 - d. **Review the IRS manual.** See if there is guidance if you are dealing with unusual issues or if there is a specialized audit manual covering your client's type of business.
 - e. **Identify and review any public information that may be available to the IRS Examiner (websites, social media postings, litigation filings, news articles, etc.).**
 - f. **Determine if there are any business disputes, soured relationships, etc. that may have led to the IRS Exam.**
2. **Keep the Client Away from the IRS Agent.** Although a Form 2848 Power of Attorney allows you to represent the taxpayer, most IRS agents now insist on a taxpayer interview. The issues being discussed will ultimately affect the amount of tax a client will pay, which tends to bias the client's judgment and sometimes skews their responses. There are rare exceptions to the taxpayer/agent contact rule. These tend to be cases where the taxpayer's quality as a potential witness or their personal knowledge of the subject matter forms part of the issue before the agent. For example, a client interview may be helpful in a hobby loss or innocent spouse case. Other than these rare situations, taxpayers and IRS agents do

not mix well. If the agent insists on an interview, ask for the questions in writing or attempt to delay the interview until the issues are crystalized and the interview can be more focused.

3. **Dealing with the Examining Agent.**

- a. **Be Courteous.** The examining agent is doing his job just like you are. By having a pleasant conversation with the agent, you might pick up some useful information. Ultimately, you might have to be confrontational but wait for the right moment. If the relationship becomes contentious, draw conflict toward you and away from the taxpayer.
 - b. **Keep Notes on all Agent Calls and Contacts.** The agent will maintain a log of all calls and contacts. If there is a dispute regarding what was discussed, it is good to have contemporaneous notes.
 - c. **Keep Records of Materials Requested and Produced or Copied.** Ask the agent to produce an Information Document Request (IDR) at the conclusion of each day asking for materials for the following working day. This produces a useful record of what they have asked to see and can be noted to show what has been produced, and when returned. It may be necessary to make copies of everything produced so that you can keep a record. If you do so, then “bates” stamp the documents and use a receipt format with the agent.
 - d. **Maintain Evidentiary Privileges, Especially the Accountant-Client Privilege.**
 - e. **Never Interpose your Personal/Professional Reputation or Veracity on Behalf of a Client.**
 - f. **Avoid Personal Attacks on the Agent.** Treat the agent professionally. Our experience is that a personally attacked agent works the case harder and “poisons” the file at appeals. A similar concern is to avoid embarrassing an inexperienced agent.
 - g. **Understand the Limitations Under Which the Agent Works.** Understand precisely how the agent is motivated and his or her manager’s criteria for measuring success or failure.
 - h. **If You are Going to Complain About an Agent, Do it in Writing, with Exhibits.** Complaining to management within the IRS about an abusive agent can be highly productive, if done correctly. Unfortunately, most taxpayers and representatives, infuriated by an agent, simply vent to his or her supervisor without result. Telephone calls may or may not become part of the administrative file and as such, lack weight. On the other hand, a written complaint becomes a part of the administrative file and therefore can be helpful as the case progresses through the system. Most complaints deal with delays and/or ever broadening audits with no resolution. The suggestion that materials requested and provided be documented (as discussed above) is important because in the complaint process it gives you ammunition to show that the agent is taking too long or is being indecisive about the scope of the audit. A complaint for delay is much more persuasive if you can attach to it IDRs that have been complied with, dates and times to show taxpayer cooperation in the process.
4. **Do Not Lie or Mislead the Agent.** Do not create or back date documents. If the client has a problem, do not make it your problem.
5. **Be Wary of Filing Returns Through the Agent.** If there are unfiled tax returns or if it is an extended examination, the IRS agent may request that all tax returns be filed with him or her. There are court cases that hold that giving a tax return to an IRS agent is not a filing. File the tax returns as required and give a copy to the IRS agent.

6. **Keep Quiet.** If a return has multiple soft spots, resist the temptation to define them and engage the agent. Let the agent tell you what he/she thinks is an issue; otherwise, you run the risk of spotlighting a previously undetected problem. As such, a passive approach is advisable until you know the agent's probable area of interest; once defined, you can move forward aggressively. The only exception is where an issue is obvious from a simple review of the tax return and bringing it to the agent's attention may be used to resolve the examination on a quicker and better basis.
7. **Always Have a Single Spokesperson for Your Taxpayer.** Nothing undermines negotiations like the confusion of multiple voices – so pick a lead representative and stick with him/her. The only exception to this is a good cop/bad cop strategy which should be selectively used and well planned.
8. **Know When to Shoot Your Bullets.** Save your arguments for a right moment. An argument surfaced prematurely may give the agent additional time to build his/her case or simply fall flat without effect.
9. **Do Not Give Away Loser Issues Too Quickly.** All issues are potential bargaining chips and should not be discarded casually. Remember that your weighing of an issue may be different from that of the IRS agent. A completely worthless position may have sufficient importance to the agent to merit a concession.
10. **Beware of Dangerous Cases.** As representatives, we occupy a difficult niche as a buffer between the taxpayer and the IRS. That role is difficult enough in a typical case, so beware of cases that offer peculiar risks. These would include clients who have unrealistic expectations i.e., they expect to pay no tax, or to have interest waived on a deficiency and generally enter your office blaming the tax return preparer for whatever problems might be on the return or the audit itself. In addition, be wary of cases where the taxpayer has committed some species of civil or criminal fraud, and you are conducting a “eggshell audit”. Know and recognize the signs of a criminal referral.
11. **Do not Invest Time on Issues the Agent has Already Fixated Upon or Where You Recognize that Negotiation is Impossible for Other Reasons.** It is difficult to persuade an agent to drop an issue they have discovered, especially where it is somewhat exotic. In addition, certain designated litigation issues are beyond the agent's control.
12. **Be Cautious in Extending the Statute of Limitations.** Do so only if you believe it will lead to a faster resolution of the examination. If not, the client may be better served by having the examination transferred to the IRS Appeals division.
13. **Never Forget the Power of Protective Refund Claims.** Don't forget that cooperation does not require an extension of the statute of limitations.

XII.

We Don't/Can't Agree with the IRS Examiner. Now What?

1. Exam Team/Manager Meeting.
2. Alternative Dispute Resolution Program.
3. IRS Appeals.
4. United States Tax Court.
5. Refund Litigation – U.S. District Court/U.S. Court of Federal Claims.
6. Audit Reconsideration.
7. OIC – Doubt as to Liability.

XIII.
Tips for Working with Appeals

1. **Write a Good and Complete Protest.**
 - a. Address what is in the examination report.
 - b. Do not address issues not in the examination report.
 - c. Tell the story with a theme.
 - d. Use alternative arguments.
 - e. If you do not have enough time to file a complete protest, file a skeletal protest and supplement (but remember AJAC).
2. **Be Sure the Appeals Officer Understands the Facts.** You and your client should have better access to the facts, and you should use that to your advantage.
3. **If the Examining Agent Files a Rebuttal Report, Ask for a Copy.**
4. **Always Remember Appeals' Greatest Weakness: The Inability to do Independent Investigation.** However, under the Appeals Judicial Approach and Culture (AJAC), if the taxpayer raises new issues or provides new evidence, the case will be returned to the examiner for consideration of the new issues or evidence.
5. **Never Forget Appeals' Greatest Strength: The Ability to Enter into Risk of Litigation Settlements.** The protest and any presentations, discussions or arguments should be directed toward convincing the IRS Appeals Officer that the government faces a significant possibility of losing the case if it litigates the matter.
6. **Do not Give Away Loser Issues Too Quickly.** All issues are potential bargaining chips and should not be discarded casually.
7. **File a Freedom of Information Act Request During or After the Examination.** You might find some usable information, including copies of the examining agent's notes.
8. **Ask for a Copy of the Administrative File.** Do so if you did not receive it in the FOIA request.
9. **Every Meeting is a Chance for Discovery.** Talking with the IRS Appeals Officer can result in usable information that is being considered in the present case or some other case involving common issues. If you did not previously ask for a copy of the administrative file, ask to look through it at the initial meeting. Review anything they offer you.
10. **Consider Making a Qualified Offer to Settle the Case.** A Qualified Offer increases the possibility of a prevailing taxpayer recovering legal fees and increases the pressure on the government to settle.
11. **Shift the Burden of Proof to the IRS by Complying with the Provisions of IRC Section 7491.** This also increases the pressure on the government to settle.

XIV.
Tips Regarding Refund Claims

1. Two important deadlines apply in refund cases: (1) the deadline to file a timely refund claim, and (2) the deadline to file a timely refund suit in federal court if the IRS denies a refund claim.
2. A refund claim generally must be filed within the later of (i) three years from the time the return was filed or (ii) two years from the time the tax was paid. I.R.C. § 6511(a).

- a. For claims filed more than three years after a timely return was filed, the amount of the refund claim is limited to payments made within two years of the date of the claim. I.R.C. § 6511(b).
 - b. If no return was filed, a refund claim must be filed within two years of when the tax was paid.
 - c. Exceptions apply to the 2-year/3-year rule in limited circumstances. See I.R.C. §§ 6551(d) & (h).
- 3. If a refund claim is examined by the IRS, most of the same tips regarding working with IRS Examination and IRS Appeals discussed above are applicable.
 - 4. Keep in mind that the IRS can make a refund, but still examine the refund claim.
 - 5. If the IRS does not act on a refund claim within six months of filing, a taxpayer has the option to file a refund suit in either U.S. District Court or the Court of Federal Claims.
 - 6. If the IRS denies a claim for refund, a taxpayer has two years from the date of the denial to file a refund suit in either U.S. District Court or the Court of Federal Claims.
 - 7. If the denial of a refund claim is being considered by IRS Appeals, the two-year time period for filing a refund suit continues to run.
 - 8. The two-year period for filing a refund suit can be extended by the IRS and taxpayer executing a Form 907, Agreement to Extend Time to Bring Suit.

XV.

Fixing a Tax Return Before the IRS Shows Up

1. Qualified Amended Return (QAR).

- a. A QAR is an amended return that corrects an error in a previously filed return prior to the taxpayer being contacted by the IRS regarding the return. Treasury Regulations Section 1.6664-2(c)(3).
- b. If an amended return is a QAR, the amounts of tax reported on the QAR will be treated as if they had been reported on the original return for purposes of computing the amount of tax “underpayment” for penalty computation purposes, unless the original return reported a fraudulent position.
- c. To be a QAR, the amended return must be filed:
 - i. Before the IRS contacts the taxpayer regarding a civil examination or criminal investigation;
 - ii. Before the IRS contacts a tax shelter promoter regarding an IRS examination;
 - iii. In the case of a pass-through transaction, before the IRS contacts the pass-through entity;
 - iv. Before the date a John Doe summons is served on a third party with respect to an activity of the taxpayer for which the taxpayer claimed a tax benefit; and
 - v. Before the IRS announces a settlement initiative for a listed transaction.

2. Voluntary Disclosure.

- a. Although an IRS voluntary disclosure does not automatically guarantee immunity from prosecution, as a matter of practice, the IRS does not pursue criminal charges against a taxpayer who meets the requirements of the voluntary disclosure program.
- b. A voluntary disclosure occurs when a taxpayer timely, truthfully, completely and voluntarily notifies the IRS about an inaccurate tax return or other document filed with the IRS.

- c. A disclosure is timely only if it is made before the IRS has initiated a civil examination or criminal investigation of the taxpayer, or before the IRS has notified the taxpayer that it intends to commence a civil examination or criminal investigation.
- d. In addition, a disclosure must be made before a third party alerts the IRS to the taxpayer's noncompliance.
- e. A taxpayer who is concerned that a former spouse, disgruntled employee or former business partner, may provide information to the IRS should consider making a voluntary disclosure before the third-party contacts the IRS.
- f. Requirements:
 - i. Taxpayers must file all required returns and reports and pay tax and interest on all previously unreported income for the six most recent tax years.
 - ii. Generally, the IRS will assess one 75 percent civil fraud penalty (Section 6663 or 6651(f)) for the year with the highest tax liability.
 - iii. The examiner will have the discretion to either expand the use of the civil fraud penalty or downgrade it to a 20 percent negligence penalty.
 - iv. In cases involving undisclosed foreign bank accounts, the IRS will follow its willful penalty guidance which typically caps the penalty at 50 percent of the highest year's balance.
 - v. The examiner will have the discretion to apply the non-willful FBAR penalty instead of the 50 percent willful penalty.

3. Streamlined Filing Submission Compliance.

- a. The streamlined filing compliance procedures are available to taxpayers certifying that their failure to report foreign financial assets and pay all tax due in respect of those assets did not result from willful conduct on their part.
- b. Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.
- c. The streamlined filing compliance procedures are designed only for individual taxpayers, including estates of individual taxpayers.
- d. The streamlined procedures are available to both U.S. individual taxpayers residing outside the United States and U.S. individual taxpayers residing in the United States.
- e. A payment of a miscellaneous offshore penalty equal to five (5) percent of the highest aggregate balance/value of the taxpayer's unreported foreign financial assets.

4. Delinquent FBAR Submission.

- a. Available to taxpayers who:
 - i. Have not filed a required FBAR;
 - ii. Are not under a civil examination or a criminal investigation by the IRS; and
 - iii. Have not already been contacted by the IRS about the delinquent FBARs.
- b. The IRS will not impose a penalty for the failure to file the delinquent FBARs if the taxpayer properly reported and paid all tax on the income from the foreign financial accounts reported on the delinquent FBARs.

5. Delinquent International Information Return Submission. Taxpayers who do not need to use the formal Voluntary Disclosure Procedures or the Streamlined Filing Compliance Procedures to file delinquent or amended tax returns to report and pay additional tax, but who:

- a. Have not filed one or more required international information returns;

- b. Have reasonable cause for not timely filing the information returns;
- c. Are not under a civil examination or a criminal investigation by the IRS; and
- d. Have not already been contacted by the IRS about the delinquent information returns, should file the delinquent information returns with a statement of all facts establishing reasonable cause for the failure to file.

XVI.

Penalties

1. The Basics.

- a. There are over 150 assessable penalties in the Internal Revenue Code.
- b. In every examination the IRS will consider penalties.
- c. It is important to understand what penalties can be assessed and what defenses can be raised in response.
- d. In most cases, obtaining penalty relief is an art not a science.

2. Penalty Handbook.

- a. Penalties exist to encourage voluntary compliance by supporting the standards of behavior required by the Internal Revenue Code.
- b. Voluntary compliance consists of preparing an accurate return, filing it timely, and paying any tax due.
- c. To be fair and effective, penalties should be severe enough to deter noncompliance, encourage noncompliant taxpayers to comply, be objectively proportioned to the offense, and be used as an opportunity to educate taxpayers and encourage their future compliance.
- d. Penalty administration should ensure consistency, accuracy and impartiality.

3. IRS Policy Statement 20-1.

- a. IRS must consider applicable penalties in every case.
- b. Taxpayers will have a reasonable opportunity to provide evidence that penalties should not apply.
- c. IRS must give full and fair consideration to such evidence.
- d. Penalties are not a “bargaining chip”.

4. Common Civil Penalties.

- a. § 6651(a)(1) — Failure to File
- b. § 6651(a)(3) — Failure to Pay
- c. § 6651(f) — Fraudulent Failure to File
- d. § 6654 — Failure to Pay Estimated Tax
- e. § 6656 — Failure to Deposit Taxes
- f. § 6662 — Accuracy Related Penalty
- g. § 6663(a) — Fraud Penalty

5. Common International Form Penalties.

- a. 31 U.S.C. §5321(a)(5) — Failure to File Form 114
- b. § 6038D — Failure to File or Incomplete Form 8938
- c. §§ 6039F, 6048 — Failure to File or Incomplete Form 3520
- d. § 6048(b) — Failure to File or Incomplete Form 3520-A
- e. §§ 6038 — Failure to File or Incomplete Form 5471
- f. § 6038A — Failure to File or Incomplete Form 5472

- g. § 6038B — Failure to File or Incomplete Form 926
- h. §§ 6038, 6038B, 6046A — Failure to File or Incomplete Form 8865
- 6. **Common Penalty Defenses.**
 - a. **IRS Section 6751(b)(1).** Failure to obtain timely supervisor approval.
 - i. No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher-level official as the Secretary may designate.
 - ii. Does not apply to penalties under IRC Sections 6651, 6654, or 6655 or any other penalty automatically calculated through electronic means.
 - b. **First Time Abatement**
 - i. Administrative waiver
 - ii. Applies to penalties for failure to file, pay on time, and / or to deposit taxes.
 - iii. Conditions:
 - (a) Taxpayer didn't previously have to file a return or had no penalties for the three tax years prior to the tax year in which a penalty applies. However, the FTA does not apply to "event-based" filing requirements.
 - (b) Taxpayer filed all currently required returns or filed an extension of time to file.
 - (c) Taxpayer paid, or arranged to pay, any tax due.
 - iv. Can be applied to FBAR
 - v. A taxpayer is not disqualified if:
 - (a) Penalties assessed more than three years before;
 - (b) Estimated tax penalties;
 - (c) Prior reasonable cause relief;
 - (d) FTA relief more than three years before; and
 - (e) Penalties on subsequent tax years.
 - vi. FTA and International Forms
 - (a) FTA generally does not apply to "event-based" filing requirements such as Forms 5471 or 5472.
 - (b) However, the IRS will abate penalties for Forms 5471 or 5472 if the related Form 1120 penalty has been abated through either an FTA or reasonable cause.
 - (c) The IRS will not accept FTA requests for Section 6038 penalties by telephone. Instead, the taxpayer must make the request in writing to the IRS. See I.R.M. Sections 21.8.2.20.2(5) & 21.8.2.21.2(5)
 - c. **Reasonable Cause.**
 - i. The "reasonable cause" standard draws on a broad range of potentially applicable guidance, including the I.R.C., Treasury Regulations, the IRS's Penalty Handbook contained in the I.R.M. (I.R.M. 20.1), and case law. "Reasonable cause is based on all the facts and circumstances. . . ." I.R.M. 20.1.1.3.2 (Nov. 21, 2017).
 - ii. For a delinquency penalty, if the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return or pay the tax, the taxpayer has reasonable cause, and the penalty will be abated or not assessed.

- iii. For an accuracy-related penalty, the most important factor is the extent of the taxpayer's effort to assess his or her proper tax liability. Exercise of ordinary business care and prudence is also a factor along with the taxpayer's training and knowledge or lack thereof.
- iv. Reasonable Cause for Late Payment or Late Filing – Important Factor
 - (a) The taxpayer's compliance history.
 - (b) Length of time to correct.
 - (c) Circumstances beyond the taxpayer's control.
- v. Common Reasons for Reasonable Cause
 - (a) Death, serious illness, or unavoidable absence;
 - (b) Fire, casualty, natural disaster, or other disturbance;
 - (c) Inability to obtain records;
 - (d) Erroneous advice;
 - (e) Ignorance of the law in conjunction with other facts and circumstances;
 - (f) Misfeasance by employee or agent leaving taxpayer "incapacitated" or "disabled";
 - (g) Financial hardship;
 - (h) Honest misunderstanding of the law;
 - (i) Uncertainty as to the state of the law;
 - (j) Reliance on erroneous information; and
 - (k) Reliance on experts.
- vi. Reasonable Cause Defense is Undermined
 - (a) Large unexplained discrepancy.
 - (b) Poor documentation.
 - (c) Tax-only motivated decision making.
 - (d) Chronology of events that don't make sense other than tax avoidance.
 - (e) Highly sophisticated taxpayer.
 - (f) "Too good to be true" results.
 - (g) Evidence of bad intent.
 - (h) Questionable valuations.
- vii. Reasonable Cause-Foreign Forms "Reasonable cause applies to most, but not all penalties. However, taxpayers who conduct business or transactions offshore or in foreign countries have a responsibility to exercise ordinary business case and prudence in determining their filing obligations and other requirements. It is not reasonable or prudent for taxpayers to have no knowledge of, or to solely rely on others for, the tax treatment of international transactions" [I.R.M. 20.1.9.1.1.1(4) (October 24, 2013)].
- d. **Accuracy Related Penalty – Reliance Defense.**
 - i. Was the advisor a competent professional who had sufficient expertise to justify reliance?
 - ii. Did the taxpayer provide necessary and accurate information to the advisor?
 - iii. Did the taxpayer rely in good faith on the advisor's judgment?
 - iv. A taxpayer's education, sophistication and business experience are relevant in determining whether the taxpayer's reliance on the advice was reasonable and in good faith.

- v. A taxpayer cannot rely on the opinion of a tax advisor to establish reasonable cause, if the tax advisor:
 - (a) Is a material advisor and participates in the organization, management, promoter on sale of the transaction or is related to any person who so participates;
 - (b) Is compensated directly or indirectly by a material advisor with respect to the transaction;
 - (c) Has a fee arrangement with respect to the transaction which is contingent on all or part of the intended tax benefits from the transaction being sustained; or
 - (d) Has a disqualifying financial interest with respect to the transaction.
- e. **Issues of First Impression Defense.**
 - i. *Peterson v. Commissioner*, 148 T.C. No. 22
 - ii. *Williams v. Commissioner*, 123 T.C. 144 (2004)
 - iii. *Hitchen v. Commissioner*, 103 T.C. 711 (1994)
 - iv. *Braddock v. Commissioner*, 95 T.C. 639 (1990)
 - v. *Wofford v. Commissioner*, 5 T.C. 1152 (1945)
- f. **Substantial Compliance Defense for International Information Returns.**
 - i. The concept of substantial compliance is longstanding. The first case, *Indiana Rolling Mills, Co.* 13 U.S. Board of Tax Appeals 1141 (1928), addressed the issue of whether a Form 1120 filed by the taxpayer was valid, thus triggering the statute of limitations.
 - ii. In 2015, the IRS released an International Practice Unit (IPU) addressing the circumstances under which the IRS will consider a Form 5471 to be “substantially incomplete” and thus subject to penalties and an extended statute of limitations.
 - iii. The IRS has also provided guidance regarding the substantially complete defense with respect to Form 5472.
 - iv. In 2017, the IRS issued a new IPU which was designed to provide IRS personnel with guidance about the meaning of substantially compliant/complete in the context of international information returns, other than Forms 5471 and 5472.
 - v. Federal District Courts and Federal Courts of Appeal generally have applied the substantial compliance doctrine more narrowly than the Tax Court.
 - vi. There are major differences between tax returns and international information returns, when it comes to substantial compliance.
- 7. **Tips for Requesting Penalty Relief.**
 - a. Call to request FTA.
 - b. File a Form 843 or attach an explanation to a late filed return.
 - c. Explain what happened in an affidavit.
 - d. What happened and when did it happen?
 - e. What facts and circumstances prevented you from filing your return or paying your tax during the period of time you did not file and/or pay your taxes timely?
 - f. How did the facts and circumstances affect your ability to file and/or pay your taxes or perform your other day-to-day responsibilities?

- g. Once the facts and circumstances changed, what actions did you take to file and/or pay your taxes?
 - h. In the case of a Corporation, Estate or Trust, did the affected person or a member of that individual's immediate family have sole authority to execute the return or make the deposit or payment?
 - i. Attach relevant documents.
 - j. Appeal the denial of abatement.
8. **Appealing a Denial of Penalty Abatement.**
- a. The IRS will issue a denial letter granting appeal rights with specific filing instructions.
 - b. The denial letter will list the specific reasons for denial, address each item in the Appeal.
 - c. Appeals must be submitted within 60 days of the date of the denial letter, preferably by certified mail.

XVII.

Tips for IRS Criminal Investigations

1. Beware of the parallel proceeding!!
2. Generally, the first notice of a criminal tax investigation is the appearance of an IRS Criminal Investigator, unannounced at the client's or advisor's office or home.
3. You will notice that they travel in pairs so they can have a witness to any conversation.
4. You should inform the agents that you wish to talk to counsel before responding. Don't talk to the government until you have spoken with your own attorney.
5. Secure legal advice from an attorney who is competent in criminal tax investigations.
6. Your attorney needs to determine your "status" in the investigation: Witness, Subject or Target.
7. Let your attorney contact the client, if appropriate. Limit your discussions with the client.
8. Make copies of all documents and date stamp them – so you will know where they came from.
9. Institute a document control system so that no documents relating to the client are accidentally destroyed.
10. Do not lie or mislead the IRS investigator to help the client.
11. Emails can be both friend and foe. The government will likely have a recording of the client but the next best thing to establish intent is to have the client's email conversations.

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Joel consults and advises businesses, wealthy individuals and families about their most demanding tax planning, estate planning and IRS controversies. He often works with tax professionals and financial specialists to help develop solutions for their clients. Joel is a Partner in the firm and is Board Certified in Tax Law by the Texas Board of Legal Specialization.

Joel has been recognized as one of the best in his field by *Texas Monthly and Law and Politics* magazines by being named a Texas Super Lawyer from 2003 through 2023. He has also been named one of the Best Lawyers in Dallas by *D Magazine* for the years 2012-2023. Mr. Crouch has been recognized by *Best Lawyers in America*® in Tax Law for the years 2015-2024. Mr. Crouch was named the *Best Lawyers 2022*® Tax Law "Lawyer of the Year" in Dallas/Ft. Worth.

Joel is a frequent speaker on procedural and substantive tax issues for legal and accounting professionals. Some of his topics include: Tax Shelter Defense, IRS Examinations, Appeals, Litigation and Collection Strategies, IRS Criminal Investigations, IRS Offshore Activities, IRS Focus on Tax Professionals, Employment Classification, IRS Penalties, and Litigation Partnership Tax Cases. He has also published various articles regarding the IRS and tax procedures.

Mary E. Wood, Partner, Meadows Collier Reed Cousins Crouch & Ungerman, LLP.

Ms. Wood's practice concentrates on resolving federal and state tax controversies, and white-collar crime such as securities, tax and bank fraud. She represents individuals, closely held businesses, and large corporations in IRS audits, appeals, and litigation in the United States Tax Courts, Federal District Courts and United States Court of Federal Claims. Ms. Wood also represents taxpayers in disputes with the Texas Comptroller of Public Accounts and other state tax agencies. Ms. Wood represents individuals and entities in business disputes and lawsuits involving fraud, breach of contract, breach of fiduciary duty, deceptive trade practices act violations, non-compete violations, business torts, and other commercial disputes.

Ms. Wood was quoted in the article, "Texas Oil Driller Settles \$618M IRS Dispute in Tax Court" by David Hansen in Law360 on January 19, 2018. She was also quoted in the article, "Self-Serving Concessions and Penalty Avoidance", in Tax Notes on March 26, 2012.

Prior to joining the firm in 2006, she was a litigation associate with a Texas law firm.

Ms. Wood was admitted to practice in Texas in 2004.

R. Damon Rowe, Partner, Meadows Collier Reed Cousins Crouch & Ungerman, LLP.

Damon Rowe joins Meadows Collier after two decades of service at the IRS. His practice focus is White-Collar Crime, Tax Controversy and Government Regulatory Litigation. He has expertise in many areas including cryptocurrency, financial crimes, civil and criminal tax, money laundering, fraud, internal investigations and the Bank Secrecy Act.

Mr. Rowe began his career at the IRS in 1998 as a Special Agent and held numerous leadership positions for the agency. He served as the Special Agent in Charge for both the Los Angeles and Dallas Field Offices in the Criminal Investigation Division. This office investigates a diverse mix of financial investigations, including cybercrime, international tax fraud, identity theft, public corruption and Bank Secrecy Act. His next leadership position was Executive Director of International Operations in the Criminal Investigation Division. He successfully designed and implemented novel strategies to detect and mitigate international financial crimes, devised an international financial crime strategy used to train and educate thousands of global investigators in over 50 countries. His most recent position was Executive Director of the Office of Fraud Enforcement. While in this position, International and Domestic fraud threat mitigation strategies were developed and implemented for all IRS business operating divisions. This office implemented a four-pillar intelligence model which aided in fraud detection. He led the COVID Relief Fraud Project and the Joint International Task Force.

Damon Rowe is currently an Adjunct Professor at Texas A&M University School of Law, where he teaches a course in international white-collar crime.

Mr. Rowe received his LL.M. in Tax from SMU Dedman School of Law and his J.D. from Texas Southern University Thurgood Marshall School of Law. He graduated from the University of Houston with a B.S. in Accounting.

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