

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Report on Civil Tax Penalties: The Need for Reform

**Developed by:
Penalty Reform Task Force**

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I. Introduction

Civil tax penalties should be, above all else, fair. Penalty provisions should be carefully crafted by Congress and sensibly administered by the executive branch to ensure that penalties deter bad conduct without deterring good conduct or punishing the innocent. Targeted, proportionate penalties that clearly articulate standards of behavior and that are administered in an even-handed and reasonable manner encourage voluntary compliance with the tax laws. On the other hand, overbroad, vaguely defined and disproportionate penalties, particularly those administered as part of a system that automatically imposes penalties or that otherwise fails to provide basic due process safeguards, create an atmosphere of arbitrariness and unfairness that is likely to discourage voluntary compliance.

Our tax system depends for its success upon voluntary compliance with the tax laws. “Civil tax penalties should exist for the purpose of encouraging voluntary compliance and not for other purposes, such as the raising of revenue.”¹ Twenty years ago, Congress enacted the Improved Penalty and Compliance Tax Act (IMPACT),² which overhauled the then-existing civil tax penalty regime and reiterated that the core goal of penalties is to encourage voluntary compliance. Unfortunately, in the twenty years since IMPACT, numerous penalty provisions have been enacted that are not directed toward, and do not achieve, the core goal of encouraging voluntary compliance. In part, this likely is due to the government’s understandable interest in combating tax shelters. However, this loss of direction also has resulted from ad hoc efforts to craft penalties and an increase in the use of penalties, rather than the substantive tax laws, to drive tax policy.

We are writing to express our concerns about the current state of civil tax penalties and to offer some suggestions for improvement. Specifically, we address the following issues:

- The trend away from voluntary compliance as the primary purpose of civil tax penalties;
- The lack of clear standards in some penalties;
- The fact that some penalties are disproportionate both in amount and severity;
- The fact that some penalties are overbroad, deter remedial and other good conduct, and punish innocent conduct;
- The trend toward strict liability;
- An erosion of basic procedural due process;
- Inconsistencies between penalty standards and the role of tax professionals;
- The increase in automated assessment of penalties that can lead to unwarranted assessments;

¹ Commissioner’s Executive Task Force on Civil Penalties, Internal Revenue Service, *Report on Civil Tax Penalties*, p.1 (February 21, 1989), available at 89 TNT 45-36, Doc 89-1586.

² P.L. 101-239, 101st Cong., 1st Sess. (1989).

- The need for better coordination and oversight of penalty administration;
- The bias in favor of asserting penalties;
- The need to improve internal IRS guidance and training; and
- The need for the IRS to increase its efforts to educate taxpayers and tax professionals.

We provide these comments with an eye toward improving overall tax policy and administration. To that end, we strongly encourage an inclusive and transparent framework for approaching this difficult task, similar to the collaborative efforts culminating in IMPACT. We urge Congress, Treasury and the Internal Revenue Service to work with taxpayers, practitioners, professional organizations and other stakeholders in developing a systematic and thoughtful approach to civil tax penalty reform and penalty administration. We welcome the opportunity to discuss these issues further with the government and other stakeholders.

II. Concerns about the Current State of Civil Tax Penalties

We recognize that penalties are an essential component of tax administration and that well-designed and well-executed civil tax penalties are effective in encouraging voluntary compliance. However, as set forth below, there are many civil tax penalties in existence today that have serious shortcomings in how they were designed, how they are enforced, or both. We are concerned that, as a result, the overall framework of civil tax penalties (including the mechanisms to enforce those penalties) is not sufficiently geared toward encouraging voluntary compliance.

A. Core Goal of Penalties – Encourage Voluntary Compliance

In the 1980s, the complexity and perceived unfairness of civil tax penalties led a broad range of stakeholders to call for a study of civil tax penalties. The Subcommittee on Oversight of the Committee on Ways and Means held a series of hearings that culminated in legislative and administrative recommendations for penalty reform. In addition, the IRS established the Commissioner's Executive Task Force on Civil Penalties ("IRS Task Force"), which had a diverse membership from within the IRS and the Department of Treasury. The IRS Task Force conducted in-depth research and consulted broadly with government officials, taxpayers, private practitioners, professional organizations, and others with respect to the history, philosophy, and sociology of penalties. The IRS Task Force presented its final Report on Civil Tax Penalties to the Subcommittee on Oversight in February 1989 ("IRS Task Force Report").³

Based on this work, in 1989 Congress enacted comprehensive penalty reform legislation. In a letter transmitting its legislative recommendations that ultimately formed the basis of IMPACT to the House Committee on Ways and Means, the Subcommittee on Oversight explained its recommendations as follows:

³ See footnote 1, *supra*.

All have agreed that the voluntary tax system in this country is remarkable. For the system to continue to work, however, it needs the respect, confidence and support of all of us. The Subcommittee discussed at length the important role penalties play in our tax system. Penalties should exist for the purpose of encouraging voluntary compliance with the tax laws. Penalties should not be used simply to raise revenues. Penalties and the standard of conduct required of taxpayers should be readily known and easily understood. Penalties should be targeted only to culpable conduct. Multiple penalties should not apply to the same misconduct. Penalties should be proportionate. Penalties should encourage compliance. Penalties should not treat taxpayers who make a good faith effort to comply with the tax laws as harshly as those taxpayers who deliberately violate the laws. Finally, administrative procedures for imposing penalties should ensure that all taxpayers are treated in a fair and equitable manner by the Internal Revenue Service. The Subcommittee's reform package will go far in making these worthy goals a reality.⁴

We believe that the statements above are still true today. Now, as then, the overriding purpose of civil tax penalties should be to encourage voluntary compliance with the tax laws. The federal tax system is built on voluntary compliance.⁵ In order to encourage voluntary compliance, penalties must be carefully designed and targeted so that they deter bad conduct without deterring good conduct or punishing innocent taxpayers. Thus, the drafting of penalty legislation should reflect the same thoughtful, rigorous and inclusive approach that led to IMPACT to ensure that the legislation articulates clear standards of behavior and makes a clean and appropriately forceful strike at the targeted conduct. The administration and enforcement of penalties should be similarly targeted and proportionate. This clarity, precision and proportionality promotes voluntary compliance because (a) it helps taxpayers understand what is appropriate conduct, and (b) it furthers fair and just outcomes, even when penalties are imposed, so that taxpayers' overall respect for the tax system is increased.

B. Shortcomings in Current Penalty Provisions

To encourage voluntary compliance penalties must articulate clear standards of behavior. In addition, penalties must be fair and administered appropriately in order to deter undesirable conduct without punishing the innocent. Thus, penalties should treat similarly situated taxpayers similarly and have sufficient flexibility to account for differences in the particular facts and circumstances of each case. We note numerous examples of deviations from these principles, as well as suggestions for improvement, below.

⁴ Letter from Sen. J.J. Pickle, Chairman, House Subcommittee on Oversight, to Sen. Dan Rostenkowski, Chairman, House Ways and Means Committee, dated June 15, 1989, available at 89 TNT 128-4, Doc 89-4923.

⁵ See Government Accountability Office, Report to the Committee on Finance, US Senate, *Tax Administration: IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts*, p. 3 (June 2009) (hereinafter "GAO Report").

1. Trend Away from Voluntary Compliance As the Primary Purpose of Penalties

As discussed above, we agree with earlier penalty studies that the primary purpose of penalties should be to encourage voluntary compliance. However, there has been a worrisome trend that new penalties are being proposed and existing penalties are being enhanced for purposes other than to increase voluntary compliance, such as raising revenue.⁶ For instance, the high revenue score of the proposed strict liability penalty associated with codification of economic substance, which has varied between a 30 percent and 40 percent penalty, has made this provision an attractive revenue raiser to offset the cost of other tax changes.⁷ Also, when enforcement issues come into the spotlight there has been a tendency to enact new and higher penalties rather than determine how to maximize the impact of existing laws and penalties. For example, legislative proposals to address offshore tax havens include a host of new or increased penalties notwithstanding the absence of data regarding the nexus between noncompliance attributable to offshore tax havens and a lack of effective penalties.⁸

There is also evidence that revenue raising may be driving penalty administration. In a recent report on IRS implementation of penalties, the Government Accountability Office (GAO) determined that the IRS was not asserting the \$50 information reporting penalty because, in the words of the report,

IRS officials said that this penalty and other format-related penalties are not assessed because the cost of developing and asserting the penalty was not worth it...The decision not to assess penalties for this error based only on the revenue received from those penalized may have actually undermined voluntary compliance.⁹

Although the intent of this example was to demonstrate that some penalties are not high enough to deter noncompliance, the real message seems to be that the IRS views penalties as a revenue source, that a cost-benefit analysis is performed around whether or not to assert penalties, and that only penalties that have high dollar amounts attached to them are worth enforcing. This leads not to a policy based on the deterrent value of penalties, but a policy that says that penalties most likely to be imposed should be high because the cost of asserting and defending them will be offset by the proceeds of the penalty. Clearly this is not consistent with the principles underlying penalty policy as embodied in IMPACT. In the case described in the GAO report, it may be better for the IRS to determine whether the underlying formatting rule for the information return is really important from an enforcement perspective, and if it is and if assertion of a penalty

⁶IRS assessments attributable to penalties are significant. For instance, in fiscal year 2007, IRS assessed more than 37.6 million civil penalties totaling more than \$29.5 billion. See GAO Report, *supra*, footnote 5, at p. 1.

⁷ Clinton Stretch, Matthew Lay, and John Galotto, "Economic Substance and Strict Liability Do Not Mix," *Tax Notes*, June 15, 2009, p. 1357, 2009 TNT 113-11, Doc 2009-11877.

⁸ See, e.g., Stop Tax Haven Abuse Act, S. 506, and H.R. 1265, 111th Cong. 1st Sess. (2009).

⁹ GAO Report, *supra*, footnote 5, at p. 9.

to accomplish that seems inefficient, the IRS should determine another way to encourage taxpayer's to use the desired formatting.

2. Some Penalties Do Not Articulate Clear Standards of Behavior

Penalties should articulate standards of behavior that are clear and understandable so that taxpayers and practitioners know the extent of their obligations, the rules do not become traps for the unwary, and noncompliant taxpayers cannot exploit the lack of clarity to avoid their obligations. It is unfair to have a provision that is undefined if it is crucial to determining rights, obligations, and potential penalties. In the case of penalties imposed on tax professionals, the less clear the underlying tax rules, the greater the need for the penalty to accommodate professional judgment.

A number of penalties do not satisfy this standard. For instance, application of sections 6662, 6662A, and 6694 varies if the transaction is a "tax shelter" or has "a significant purpose" of federal income tax avoidance or evasion. Section 6662(d)(2)(C)(ii) defines "tax shelter" for purposes of the accuracy-related penalty where the transaction is not a reportable transaction as any entity, plan, or arrangement with "a significant purpose" of federal income tax avoidance or evasion. Section 6662A provides that reportable transactions other than a listed transaction will be subject to the enhanced accuracy-related penalty for reportable transactions if the transaction has "a significant purpose" of avoiding or evading federal income tax. The rules applicable to a tax return preparer also depend on whether the return position relates to a "tax shelter" under section 6662(d)(2)(C)(ii) or "a significant purpose" reportable transaction subject to section 6662A.¹⁰

The determination of whether there is a "tax shelter" or "a significant purpose" transaction is crucial. The level of confidence required to avoid penalties for "tax shelters" and "a significant purpose" transactions is significantly higher than in other contexts. Taxpayers and preparers must satisfy the more likely than not standard (requiring a greater than 50 percent likelihood of success, if challenged) instead of the substantial authority standard, to avoid a section 6662(b)(2) substantial understatement penalty and a section 6694 preparer penalty. The section 6662A penalty applies only if the transaction is a listed transaction or other reportable transaction with "a significant purpose" to avoid tax.

Yet neither the term "tax shelter" nor "a significant purpose" has been clearly defined. To the non-tax professional, the term "tax shelter" connotes that the entity, plan or arrangement is abusive and that the nature of the entity, plan, or arrangement as a tax shelter is evident to all. However, under the technical rules defining tax shelter nothing could be further from the truth. Uncertainties are magnified in the case of preparers because the taxpayer, not the preparer, is in the best position to know the purpose for entering into the transaction. Even if the purpose is known to the preparer, there is no

¹⁰These terms are also relevant to determining which tax advice rules apply under section 10.35 of Circular 230 and whether the exception to the federally authorized tax practitioner privilege under section 7525 applies. See e.g., *Valero Energy Corp. v. United States*, ___ F.3d ___, 2009 WL 1675732, C.A.7 (Ill.), June 17, 2009 (NO. 08-3473). As such, any definition for penalty purposes should apply consistently to these provisions.

workable standard for the preparer to objectively assess whether a taxpayer's purpose is "significant."

Further, the determination of whether the taxpayer has participated in a reportable transaction is essential to determining whether a number of very onerous penalties will apply.¹¹ And yet, determining whether a transaction is reportable is not always clear because key terms such as "substantially similar," "participation," and "transaction" are vague and broadly defined. Further, the application of the reportable transaction rules to transactions that are not abusive and that are supported by a strong level of authority is so counter-intuitive that many taxpayers and tax professionals are simply unaware that the rules apply to an extraordinarily broad range of transactions.

These penalties also apply in the case of transactions "substantially similar" to listed transactions and transactions of interest -- two categories of reportable transactions. Because the term "substantially similar" is not clearly defined, and the IRS regulations require that the term be "broadly construed," it is possible for the reportable transaction rules to cover routine, common, and clearly non-abusive transactions.¹²

In the case of listed transactions and transactions of interest, "participation" may be defined in the notice identifying the transaction as a listed transaction or a transaction of interest. These notices can be issued years after the tax year in which the transaction occurred, compounding the problem of complying up front with vague standards. The definition of the term "transaction" is also unclear because of how broadly it is defined in the regulations and how broadly it is applied by the IRS.¹³

Despite the uncertainties surrounding whether or not a transaction will be treated as a tax shelter, general provisions allowing taxpayers and preparers to avoid penalties through transparency are not, but should be, available in this case. Generally, disclosure protects taxpayers from accuracy-related penalties provided there is a reasonable basis for the position causing the tax liability to be incorrectly reported. However, a taxpayer disclosing a position that the taxpayer did not believe was a tax shelter, but that is later determined to be a tax shelter, (the definition of which is unclear, as discussed above), faces a section 6662(d) penalty nonetheless. The same is true with respect to the section 6662A penalty in the case of a reportable transaction with "a significant purpose" to avoid federal income tax, although disclosure may reduce the penalty rate from 30 percent to 20 percent.

¹¹See e.g., sections 4965, 6662A, 6707, 6707A, and 6708. While not technically a penalty, section 4965 has a similar effect and is so related to the issues underlying the concerns raised here that we believe it should be addressed in this context.

¹² Treas. Reg. §1.6011-4(c)(4). This issue was clearly demonstrated when guidance issued to define what substantially similar meant in the case of the Intermediary listed transaction had to be superseded to calm the tax community's fears that the substantially similar definition would sweep every merger and acquisition transaction, no matter how routine and benign, into the listed transaction category. See Notice 2008-111, 2008-51 I.R.B. 1299, superseding Notice 2008-20, 2008-1 C.B. 406, and clarifying Notice 2001-16, 2001-1 C.B. 730.

¹³ Treas. Reg. §1.6011-4(b)(1) defines a transaction for purposes of the reportable transaction rules as including "all of the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement, and includes any series of steps carried out as part of a plan."

Another area where there is uncertainty involves accuracy-related penalties for valuation understatements, particularly regarding when the extraordinary 40 percent penalty should apply. Although we believe that a valuation penalty should only apply to misstatements of fact, not law (e.g., it should apply in the case of a valuation supporting the cost or worth of property, not when issues arise about whether adjustments to basis are supported by the tax law), this is not the way the penalty has been administered. Further, if the determination is that the valuation penalty should apply to misstatements of law, then safeguards applicable to other accuracy-related penalties are needed, such as requiring that the return position meet a minimum level of accuracy before the penalty applies as is the case with the negligence and substantial understatement of income tax penalties.

3. Some Penalties Are Disproportionate

The amount of a penalty should be proportionate to the degree of misconduct exhibited and to the degree of harm resulting from that misconduct. Stacking penalties may increase the aggregate penalty amount so that it is disproportionate to the degree of misconduct or the degree of harm. A penalty that is viewed as excessive undermines voluntary compliance and may be less likely to be imposed. To that point, critics of the proposed 30 percent economic substance penalty have argued against creating a penalty that will cause complexity and consternation, but ultimately will not be sustained by the courts.¹⁴

Willful misconduct generally should be penalized more harshly than negligent noncompliance, but this is not always so. For instance, in the case of preparer penalties, both willful and non-willful conduct are subject to the exact same monetary penalty once fees hit \$10,000 and referrals to the Office of Professional Responsibility are mandatory in both cases regardless of the severity of the conduct.¹⁵ The decision to refer a preparer penalty case should be made on a case-by-case basis and depends on the facts and circumstances.

One of the clearest examples of disproportionate penalties involves the section 6707A¹⁶ and section 6707 penalties and the section 4965 excise tax. Basically, these are information reporting penalties that are significantly disproportionate to the conduct and incompatible with other information reporting penalties.¹⁷ The Taxpayer Advocate, Commissioner Shulman, and members of Congress have recently acknowledged that the

¹⁴ See Stretch, Lay, and Galotto, *supra*, at footnote 7. There have also been proposals for a 40 percent penalty in the case of a lack of economic substance.

¹⁵ See IRM 4.11.55.4.2.2.1. In the Preamble to the proposed preparer penalty regulations the IRS said it would revise the Internal Revenue Manual to prevent automatic referrals of section 6694(a) violations. See REG-129243-07, 73 FR 34560 (6/17/2008).

¹⁶ As of January 2009, IRS assessed 98 section 6707A penalties totaling \$13.7 million. In addition, 1188 returns had been assigned to field groups for review with respect to this penalty. See GAO Report, *supra*, footnote 5, at pp.14-15.

¹⁷ For example, compared with the penalty for failure to file the Form 5471 of \$10,000, the penalty for failure to file a Form 8886 may be as high as \$200,000 and the failure to file Form 8918 may be as high as the greater of \$200,000 or 75 percent of the fees received by the material advisor.

section 6707A penalty often is excessive and needs to be revised.¹⁸ According to Senator Grassley, “[t]he penalty should be commensurate with the transgression.”¹⁹

Other examples of disproportionate penalties include the section 6708 penalty where, despite the fact that it may involve production of vast quantities of information, some of which may be subject to claims of privilege necessitating communication with clients and their other advisors and creation of a privilege log, material advisors may be subject to a \$10,000 a day penalty with no cap if the IRS determines that efforts to timely produce documents are not sufficient. In addition, the section 6662A penalty and part of the section 4965 excise tax are calculated assuming that the taxpayer is subject to the highest rate of tax under section 1 or section 11 regardless of the rate that actually applies. Further, in the case of taxpayers in a net loss position, section 6662A applies regardless of whether there is any underpayment of tax resulting from the behavior that triggered the penalty.

4. Some Penalties Are Overbroad, Deter Remedial and Other Good Conduct, and Punish Innocent Conduct

Taxpayers trying to do the right thing should not be subject to onerous standards that are ineffective in deterring taxpayers who are intent on evading the law. Penalties should encourage, not discourage, disclosure, and provide incentives for correction of inadvertent errors. Penalties should not apply in the case of mere footfaults, but they often do. For instance, under the section 6707A regulations an otherwise compliant taxpayer who discloses a reportable transaction for the first time on the tax return, but not with the Office of Tax Shelter Analysis (or with the Office of Tax Shelter Analysis but not with the return) because of a misunderstanding of the rules or inadvertence is subject to a section 6707A penalty. A taxpayer who intentionally fails to disclose a reportable transaction at all faces the same penalty. Similarly, tax-exempt entities and entity managers who may not have sufficient information to determine that a transaction is a listed transaction or that it will become a subsequently listed transaction may nevertheless be subject to onerous consequences under section 4965. Once it is discovered that the entity inadvertently participated in a listed transaction or subsequently listed transaction, the entity does not have the opportunity, which it should, to exit the strategy and avoid these consequences.

Penalties are seen as a stigma and the taint often remains even if the penalty has been reversed. Thus, wrongly asserted penalties have the potential to cause greater harm than

¹⁸ National Taxpayer Advocate, 2008 Annual Report to Congress, vol. 2, pp. 21-24 (hereinafter "NTA 2008 Report") available at 2009 TNT 4-21, Doc 2009-241. Testimony of Douglas Shulman, Commissioner, Internal Revenue Service, before the House Ways and Means Subcommittee on Oversight, June 04, 2009, available at 2009 TNT 106-2, Doc 2009-12650. Letter from Sen. Max Baucus, Sen. Charles Grassley, Rep. John Lewis, and Rep. Charles W. Boustany, Jr. to IRS Commissioner Douglas H. Shulman, dated June 12, 2009, available at 2009 TNT 113-25, Doc 2009-13542. See also, Submission of Small Business Council of America for Hearing of House Ways and Means Subcommittee on Oversight, dated June 4, 2009, available at 2009 TNT 106-36, Doc 2009-12663, for examples of unintended listed transaction penalties.

¹⁹See “Lawmakers Concerned About Unfair Penalties on Small Businesses,” *Tax Notes*, June 15, 2009, 2009 TNT 113-25, Doc 2009-13542.

more neutral costs such as payment of additional tax or interest. Overbroad penalties that discourage remedial or other good conduct undermine faith in the fairness of the system. This may undercut compliance and transparency or cause taxpayers to forego congressionally intended benefits to avoid possible missteps and the resulting penalty consequences. Therefore, penalties should be crafted and implemented judiciously to ensure that they are more beneficial than harmful to the overall functioning of the tax system.

Although disclosure and transparency should be encouraged, there are many examples where disclosure is actually discouraged. For instance, taxpayers can avoid being penalized at a 30 percent penalty rate under section 6662A if disclosure is made before IRS contact by filing a "qualified amended return"). However, regulations explicitly state that this same disclosure is not effective to avoid the section 6707A penalty. Therefore, the penalty rules discourage disclosure because while disclosure may protect a taxpayer against a possible section 6662A accuracy-related penalty, it also may expose the taxpayer to a section 6707A failure to disclose penalty. Taxpayers should be able to avoid both the section 6662A penalty and the section 6707A penalty by filing the equivalent of a qualified amended return. In fact, the IRS should consider expanding the use of qualified amended returns to correct inadvertent errors and avoid penalties in other areas as well. Similarly, valuation penalties should not apply if there is adequate disclosure.

5. There Has Been an Unwelcome Trend Toward Strict Liability

IRS discretion to waive and abate penalties where the taxpayer demonstrates reasonable cause and good faith is needed most when the tax laws are complex and the potential sanction is harsh. This is especially true where the taxpayer's state of mind is central to the conduct that is subject to penalty. Because it is not possible to anticipate every possible situation to which a penalty might apply, permitting a reasonable cause defense and avoiding fixed-dollar amount penalties helps to ensure that a disproportionately large penalty will not be applied to an unforeseen and inappropriate set of facts.

Over the past several decades, there has been an exponential increase in the complexity of the tax laws and a proliferation of increasingly severe civil tax penalties. However, rather than responding by providing the IRS with increased flexibility to take into account the particular facts and circumstances, the tax laws have evidenced a trend toward strict liability. This trend has manifested itself in a number of ways, including: (1) disallowing reasonable cause relief or waiver outright; (2) providing for limited waiver authority and, in some cases, prohibiting judicial review; and (3) creating a so-called "reasonable cause and good faith" exception that is really an exception based on the level of confidence for the technical position rather than the taxpayer's particular facts and circumstances.

There are numerous examples of this trend. For instance, in the case of the proposed economic substance penalty, the determination of whether a transaction meets the economic substance requirements is complex at best, meaning that this significant penalty could apply in cases where it is not warranted. However, rather than providing the IRS with necessary discretion to waive the penalty based on the facts and circumstances, the

provision as proposed has no reasonable cause provision. Similarly, the ability to demonstrate reasonable cause to avoid the section 6662(d) penalty is denied in "tax shelters," a term that, as we discussed earlier, may have broad applicability because it has not been clearly defined. Also, the reasonable cause exception is not available for certain penalties related to the complex area of valuation.²⁰

Sometimes, a reasonable cause exception is provided but is so limited as to be almost nonexistent. In the case of the section 6662A accuracy-related penalty for reportable transactions, the reasonable cause exception is limited in a number of ways. First, the position must be supported by at least a "more likely than not" level of confidence. Second, the taxpayer is unable to rely on the opinion of an advisor to establish that the level of confidence has been satisfied if either the advisor or the opinion is "disqualified."²¹ Generally, an advisor is disqualified if a minimum fee threshold is satisfied and the transaction is a reportable transaction. Under these criteria, purely objective factors (e.g., corporation pays more than \$250,000 for an opinion with respect to a reorganization where a subsidiary is sold for an \$11 million section 165 loss) in a non-abusive transaction could result in the taxpayer not being able to rely on a "more likely than not" opinion of a qualified tax professional. This result unnecessarily increases a taxpayer's compliance costs. It also is draconian, unfair, and does nothing to address abusive transactions or increase voluntary compliance.

Similarly, the rescission provisions applicable to sections 6707 and 6707A are so limited (and in the case of listed transactions not available at all) that, despite the complexity and uncertainty surrounding the underlying conduct that is subject to penalty, there is little agency flexibility. Congress and the IRS have reacted to this lack of flexibility in response to extreme examples of extraordinary section 6707A penalty amounts imposed on small businesses.²² There are now bills pending in Congress to add a reasonable cause exception to section 6707A and the IRS has suspended collection of section 6707A penalties in the case of small assessments.²³ While this is a good first step to address the unfairness with respect to this particular penalty and this particular class of taxpayer, it should not be seen as an end in itself. Other classes of taxpayers in equally sympathetic circumstances face harsh penalty consequences with little opportunity to seek relief.²⁴ Thus, we view these recent actions by Congress and the IRS as a good first step in what we hope will be a continuing process toward evaluation and reform of the overall civil tax penalty system.

²⁰ See e.g., sections 6664(c)(2) and 6695A.

²¹ See section 6664(d).

²² See examples in Small Business Council Submission, *supra*, at footnote 18, and NTA 2008 Report, *supra*, footnote 18, at vol. 2, p. 23.

²³ For current bills, see H.R. 2143 and S. 765, 111th Cong., 1st Sess. (2009). For reference to additional proposed legislation, see June 2, 2009 letter to IRS Commissioner Shulman, *supra*, at footnote 18. For suspension of collection, see Letter from Douglas H. Shulman, IRS Commissioner, to Rep. John Lewis, dated July 6, 2009, available at 2009 TNT 128-15, Doc 15335.

²⁴ For instance, reportable transaction penalties imposed on tax-exempt entities are also harsh and relief is limited. The section 4965 excise tax on both a tax-exempt entity and its managers may apply even if the underlying transaction did not result in an understatement of tax by any party to the transaction. Providing for a reasonable cause defense and more administrative discretion would help to avoid an inappropriate imposition of this excise tax.

6. Some Penalty Provisions Do Not Provide Basic Procedural Due Process

Penalties should apply prospectively to future conduct and not retroactively to conduct that was appropriate at the time the conduct occurred. Judicial review of an IRS decision to impose a penalty or to deny waiver is an important constitutional check on executive authority. Statutes that prohibit judicial review of agency penalty determinations undermine voluntary compliance by undercutting taxpayers' faith in the system and eliminating an essential and expected avenue of potential redress.

Penalties that key off of listed transactions or transactions of interest are examples of penalties that are applied retroactively. Stringent accuracy-related penalties (section 6662A), failure to disclose penalties (sections 6707 and 6707A), and the excise tax on tax-exempt entities and entity managers (section 4965) may apply in the case of a transaction that is identified as a listed transaction or transaction of interest (including a transaction substantially similar to those transactions) **after** the return is filed reflecting the transaction.²⁵ Transactions that were not subject to disclosure and reportable transaction penalties when the taxpayer entered into them suddenly may be subject to these rules without warning.²⁶

Equally if not more problematic is the fact that listed transactions and transactions of interest are first announced in arcane tax publications. Even if the taxpayer has access to the list of these transactions, they are numerous (there are currently 34 listed transactions and 4 transactions of interest) and complex, with the result that unsophisticated taxpayers and practitioners may have difficulty in understanding the transaction being referred to. Exacerbating this problem is the fact that the section 6707 and section 6707A penalties are prime examples of situations where the statute prohibits judicial review of the Commissioner's exercise of discretion with respect to rescission of these penalties. Because of this, the IRS should consider additional ways to educate taxpayers and practitioners about listed transactions and transactions of interest and the reportable transaction regime so that there is more sensitivity by the public about possible disclosure obligations.

Taxpayers should be informed of their rights to contest penalties and to be afforded a timely and meaningful opportunity to be heard before assessment of the penalty. In general, this would include the right to an independent review by the IRS Appeals office, as well as access to the courts. Pre-assessment rights are particularly important where the underlying tax provision or penalty standards are complex, the amount of the penalty is high, or fact-specific defenses such as reasonable cause are available.

Increasingly, penalties are assessed using automated processes to identify and compute additional tax due, penalties, and interest without the benefit of pre-assessment rights to

²⁵ Note that the section 4965 excise tax does not apply in the case of transactions of interest.

²⁶ In the case of listed transactions and transactions of interest identified after the taxpayer files a return for the year in which the taxpayer participated in the transaction, the regulations require disclosure within 90 days of the announcement of the transaction as a listed transaction or a transaction of interest in published guidance. This may be the case even if the taxpayer participated in the transaction as far back as 1999 in the case of a listed transaction. The transactions of interest rule also applies to transactions entered into before the transaction is identified, however, the reach of the rules goes back to transactions entered into after November 2, 2006, rather than 1999.

pursue reasonable cause and other defenses.²⁷ In many instances, taxpayers pay penalties even if they are unwarranted because it is so difficult and costly to challenge a penalty once it is assessed. Examples are assessment of the section 6662 penalty on notices from matching programs or correspondence audits (even though reasonable cause might apply or the determination of an underpayment is incorrect), the \$10,000 penalty in the case of Forms 5471 filed with Forms 1120 filed after the deadline (even though reasonable cause might apply), and the section 6676 penalty if part of a refund claim is denied (even though the penalty does not apply if there is a reasonable basis for the claim).

In addition, there is no pre-assessment review by Appeals for international penalties assessed under Chapter 61 of the Internal Revenue Code,²⁸ but there is pre-assessment review for international penalties under Chapter 68 of the Code.²⁹ It makes no policy sense and it is unfair for a taxpayer's right to contest an international penalty to turn merely on the penalty's placement within the Code; namely, whether the penalty is assessable under Chapter 61 or 68.

There are other procedural issues with respect to penalties that bring into question basic due process rights. For instance, partners are not currently allowed to raise partner level defenses to penalties such as the reasonable cause defense in partnership level proceedings in the case of TEFRA partnerships. Currently, the regulations provide that partners in TEFRA partnerships may be able to assert a defense only after the partnership level determinations are sustained by a court; partners pay their share of taxes, interest and penalties; partners file claims for refund; and then the partners return to a different court (or judge) to contest the penalties. While this general rule may be necessary in the case of TEFRA partnerships with a large number of partners, the current approach may postpone the fair resolution of a penalty issue and is wasteful of judicial, governmental, and taxpayer resources in the case of relatively small TEFRA partnerships. Small, closely-held TEFRA partnerships should be provided relief in these situations.

Another area involves preparer penalties. During an examination of the taxpayer, agents are required to consider whether preparer penalties are applicable. Procedures state that preparer tax return information, including consideration of preparer penalties against the preparer, should be protected. However, in the course of developing cases against preparers, preparers may have legitimate concerns that their tax information is being shared with others. Accordingly, preparers should have a means for redress if during an examination of the taxpayer the preparer believes that the agent makes the taxpayer aware that a preparer penalty is being considered.

²⁷ According to the IRS Data Book for FY08, 77.7 percent of the total of 1,540,771 audits (or 1,110,211 audits) were correspondence audits. In addition, according to IRS in FY08 there were 3.53 million contacts and 2.795 million assessments under the Automated Underreporter Program and 1.5 million contacts and 756,539 assessments under the Automated Substitute for Return Program. Penalties are normally asserted when the automated notices are sent under each of these programs. Assuming that this is the case and taxpayers were not receiving notices from more than one program, that amounts to automated assertion of penalties to over 6 million taxpayers in these programs alone (i.e., not taking into account other automated programs such as the \$10,000 penalty for Forms 5471 filed with late Forms 1120).

²⁸ See e.g., the penalty for failing to timely file a Form 5471 under section 6038(b) and the penalties under sections 6038A, 6038B, 6038C, and 6038E.

²⁹ See e.g., the penalties under sections 6652, 6677 6679, and 6712.

7. Some Penalty Standards Are Not Consistent with the Role of Tax Professionals

The standards applicable to tax professionals must reflect the fact that the role of tax professionals differs from the role of taxpayers. While the taxpayer is ultimately responsible for the positions taken on the return, tax compliance increases and our self-assessment system benefits when taxpayers seek the assistance of a competent tax professional.³⁰ Penalties imposed on tax professionals should be based on facts and circumstances known (or which should be known) by the professional and over which the tax professional has control. The standards applicable to tax professionals should not create a conflict with taxpayers. Penalties should not discourage taxpayers from seeking tax advice from a professional.³¹

For instance, the standards under section 6694 require the preparer to identify whether a transaction is a "tax shelter" under section 6662(d)(2)(C)(ii) or is subject to penalty under section 6662A. However, preparers are not in the best position to know the taxpayer's purpose for entering into a particular transaction, let alone assess whether such a purpose is significant. This is particularly true in light of the fact that there is no guidance to assist in determining when a purpose is "significant." Therefore, unlike the current rule in section 6694, the preparer should be able to avoid the penalty with respect to a tax position by preparing the return with adequate disclosure if the position has at least a reasonable basis.

In addition, differing standards for taxpayers under section 6662 and preparers under section 6694 create a potential conflict of interest. First, the taxpayer is not subject to an understatement penalty under section 6662(d) unless the understatement is "substantial"³² There is no such floor before the preparer penalty applies. Next, in the case of the penalty for disregard of a rule, the current regulations provide that in certain cases the section 6662 penalty will not apply if the position has at least a realistic possibility of success, whereas section 6694 provides that the position must be supported by substantial authority for the preparer to avoid the penalty.³³ Because of the potential conflicts and the sometimes higher standards applied to preparers, taxpayers may choose not to seek the assistance of a tax professional in preparing returns.

³⁰ See Preamble to proposed regulations under IRC sections 6694 and 6695, REG-129243-07, 73 FR 34560 (6/17/2008) (stating "[t]ax return preparers are critical to ensuring compliance with the Federal tax laws and are an important component in the IRS's administration of those laws."). See also Servicewide Key Messages for Tax Professionals from the IRS website as of May 27, 2009 (stating "[t]ax return preparers perform a vital function in assisting taxpayers in meeting their tax obligations.")

³¹National Taxpayer Advocate, 2007 Annual Report to Congress, vol. 1, p. 140.

³²An understatement for this purpose is substantial if the amount exceeds the greater of 10 percent of the tax shown on the return or \$5,000, or in the case of a corporation, the amount exceeds the lesser of 10 percent of the tax shown on the return (\$10,000 if greater) or \$10 million. See section 6662(d)(1).

³³Compare Treas. Reg. §1.6662-3(a) with Treas. Reg. §1.6694-3(c)(3). The substantial authority standard is more stringent than the realistic possibility of success standard. See Preamble, REG-129243-07, 73 FR 34560 (6/17/2008)(stating that "[b]y adopting the "realistic possibility" standard for tax return preparers, and the higher "substantial authority" standard for taxpayers with respect to undisclosed positions, OBRA 1989 created a disparity between the penalty treatment of tax return preparers and most taxpayers subject to income tax.").

Thus, current preparer penalties seem to be driven less by a desire to encourage preparer compliance and more by a desire to use the preparer as an extension of the IRS to enforce taxpayer compliance. In effect, the preparer penalty standards "deputize" the preparer and shift the responsibility for enforcing the tax laws away from the IRS to the preparer.³⁴ Although the preparer is not armed with first-hand information about the taxpayer's activities, the preparer is "accountable"³⁵ for the taxpayer's transactions and decisions. This responsibility for the taxpayer's compliance is misplaced, ignores the fundamental role (and limitations) of the preparer as an advisor, and creates the potential for conflicts of interest.

C. Shortcomings in Current Penalty Administration

The Commissioner of the IRS is responsible for ensuring effective administration of the civil tax penalty system. Although Congress enacts penalties, the Commissioner is the caretaker of tax penalty administration. It is useful to recall the statement made by the House Ways and Means Committee, Subcommittee of Oversight, in transmitting the proposed IMPACT legislation, listing the following objectives that the IRS should follow as it handles each penalty case:

(1) Similar cases and similarly situated taxpayers should be treated similarly; (2) The taxpayer should have the opportunity to have his interests heard and considered. This includes providing a forum, listening to his views, and modifying decisions when appropriate; (3) IRS should strive to make a good substantive decision in the first instance. A wrong decision, even though corrected eventually, negatively impacts voluntary compliance; (4) An adequate opportunity should exist for incorrect decisions to be corrected. This encompasses appeals to the office that asserts the penalty, a separate appeals apparatus, and access to the court system; (5) The agency should act in an impartial and honest way. While each IRS representative appropriately approaches his or her job from a government perspective and with the objective of protecting the government's interest, the true interest of the government is the impartial enforcement of the tax laws, and this requires that treatment of taxpayers not be biased in the government's favor; (6) IRS should help taxpayers understand their legal rights and assist them in understanding their appeal rights. IRS should scrupulously observe the taxpayer's procedural rights; and, (7) IRS should seek to promptly process and resolve each taxpayer's case. Promptness requires a certain amount of initial informality in the dispute resolution process." The Subcommittee commends the IRS for its commitment to such worthy goals and intends to hold the IRS to these standards. To assist the IRS in achieving these goals and to insure effective implementation of the Subcommittee's legislative package, the Oversight

³⁴ Tom Herman, "The IRS Has A New Weapon: Your Tax Pro," *The Wall Street Journal*, July 11, 2007, available online at http://online.wsj.com/public/article_print/SB118411878229462879.html

³⁵ See Memorandum from John H. Imhoff, Jr., Director, Specialty Programs in the Small Business/Self-Employed Operating Division to Chief, Estate and Gift Tax, dated May 8, 2009 (SBSE-04-0509-009) (stating that "[t]he purpose of proposing and assessing penalties on return preparers is to encourage accountability, affect behavior, and increase voluntary compliance").

Subcommittee has developed additional administrative recommendations to accompany the statutory penalty reform package.³⁶

We believe that, as measured against these principles, certain shortcomings in tax administration have emerged, as described below.

1. There Has Been an Increase in Automated Assessment of Penalties

Over 6 million taxpayers had automated penalties asserted against them in fiscal year 2008.³⁷ In many cases, there are facts and circumstances particular to a taxpayer that is sufficient to warrant abatement of the penalty. However, the time and money necessary to work through the complex and often incomprehensible process of challenging penalties means that many taxpayers performing a cost-benefit analysis will choose to pay incorrect and unwarranted penalties rather than challenge them. When taxpayers do challenge incorrect penalty assessments, there is a waste of both IRS and taxpayer resources.

Taxpayers should not be in a position where penalties are paid merely because it is less costly to do so than to expend the resources to contest them. Penalties should be correctly asserted in the first instance to avoid unnecessary use of resources by all parties involved.³⁸ The opportunity to challenge incorrect penalties early in the process (i.e., prior to assessment) and prompt resolution of penalty disputes benefit both the IRS and the taxpayer. The forum and process for challenging penalties should be appropriate to the taxpayer and the circumstances. Consideration should be given to a streamlined process for administrative challenges to penalties below a certain amount, similar to small case procedures in Tax Court.

2. There Should be Greater Coordination and Oversight of Penalty Administration

Effective penalty administration requires a coordinated effort on the part of the IRS to ensure consistency and competence across and within Operating Divisions. The office with overall responsibility for penalty administration should be prominent within the IRS and have the authority to influence penalty policy throughout the IRS. Procedures should be in place for review and oversight of penalty administration. Sufficient data should be collected to enable evaluation of the administration and enforcement of penalties. Current systems in place for review and oversight of penalty administration should be regularly evaluated for efficacy and compliance with policies and should be a source of data on penalty administration.

Studies by the Treasury Inspector General for Tax Administration (TIGTA), the National Taxpayer Advocate, and GAO have concluded that there is significant room for

³⁶ Sen. J.J. Pickle Letter, *supra*, at footnote 4.

³⁷ See footnote 27, *supra*.

³⁸ In fiscal year 2007, IRS assessed more than 37.6 million civil tax penalties, totaling more than \$29.5 billion. During the same period, IRS abated or rescinded in whole or in part more than 4.9 million penalties totaling more than \$11.1 billion. See GAO Report, *supra*, footnote 5, at p. 1.

improvement with respect to IRS oversight and collection of data regarding penalty administration.³⁹ In light of this, we urge policymakers to develop strategies to ensure that immediate steps are taken to develop such systems. Absent IRS oversight of penalty administration and the data such oversight can provide, it is difficult to accurately evaluate the effectiveness of penalties in encouraging voluntary compliance.⁴⁰

In addition, the IRS should evaluate whether the Servicewide Penalties Group is the best office to have overall responsibility for penalty administration and if so, whether the placement of that office within the IRS organizational structure is optimal to allow that office to perform its mission, including evaluating and coordinating penalty administration throughout the major Operating Divisions. Currently the Servicewide Penalties Group resides under Exam Policy within the Small Business/Self-Employed (SB/SE) Operating Division. The IRS should review whether it may be beneficial to have the office with overall responsibility for review and oversight of penalty administration report directly to the Deputy Commissioner of Service and Enforcement.

One area in need of evaluation by the IRS involves the use of penalties to enforce data collection.⁴¹ Questions have been raised regarding whether penalties are effective in encouraging compliance with information gathering efforts and whether the data collected is actually being used by the IRS to actively promote sound tax administration.⁴² We believe that such an evaluation would go a long way to increasing compliance and perceptions of fairness.

3. The Penalty Administration System Has Developed Biases in Favor of Asserting Penalties

One of the results of IMPACT was an affirmative statement by the IRS regarding its policy on penalties -- the Penalty Policy Statement. Consistent with the overriding principle of IMPACT, the Penalty Policy Statement affirmed that the "Service will design, administer, and evaluate penalty programs solely on the basis of whether they do the best possible job of encouraging voluntary compliance."⁴³ The original articulation of

³⁹ See, in general: GAO Report; Treasury Inspector General for Tax Administration, *Management Advisory Report: Ineffective Administration of the Individual Taxpayer Penalty Program Creates Inequity* (April 2001); Government Accountability Office, Report to the Committee on Finance, US Senate, *Tax Administration: The Internal Revenue Service Can Improve Its Management of Paper Case Files* (September 2007); Treasury Inspector General for Tax Administration Report: *While Documentation Was Not Available to Fully Assess The Return Preparer Program, Identification And Processing of Preparer Penalties Can Be Improved* (August 2008); NTA 2008 Report, *supra*, footnote 18, at vol. 2, pp. 5-6.

⁴⁰ For example, Section 6751(b) provides a general rule that no penalty will be assessed unless the initial determination of the assessment is personally approved (in writing) by the immediate supervisor of the individual making the determination. Exceptions are provided for penalties that are assessed by electronic means. IRM 20.1.1.2.3 provides procedures to implement section 6751. The level of compliance with these provisions is unclear and could be an area for further study.

⁴¹ See e.g., sections 6707A, 6038, and 6038B.

⁴² For instance, there are significant penalties for failure to file Form 8886. However, sufficient information about the IRS's ability to use the information collected on the forms to further the goals of combating abusive tax transactions has not been made available.

⁴³ See IRS Penalty Policy Statement P-1-18 (August 20, 1998).

the IRS's penalty philosophy in the Penalty Policy Statement announced in the 1980s was revised in 2004 in ways that on the surface appear insignificant but on closer inspection indicate an important and telling shift in the agency's approach toward penalty administration.⁴⁴ Although the Penalty Policy Statement continues to affirm that penalties must encourage voluntary compliance, the Statement qualifies that goal by stressing the importance of efficiency in penalty administration and the need for penalties to serve as an economic deterrent in “abusive” transactions. For this purpose, an “abusive” transaction is defined expansively as any transaction with “a significant purpose” to avoid or evade federal tax.

Current IRS policies prohibit a decrease in penalties in exchange for an increase in tax or assessment of penalties in exchange for a reduction of tax (sometimes referred to as “trading of penalties”). Some policies also require separate consideration of certain penalties (e.g., accuracy-related penalties) and written justification when these penalties are not asserted.⁴⁵ While these policies appear reasonable on their face, together, and with no ability for the agent to exercise discretion, they create an unfair bias in favor of assertion of penalties which undermines the appearance of impartiality. This is further exacerbated by the fact that the IRS is increasingly mandating consideration of penalties in various contexts such as the section 6662 accuracy-related penalty in “a significant purpose” contexts, and the section 6694 penalty in all taxpayer examinations involving a paid return preparer.⁴⁶

4. Internal IRS Guidance and Training Should Be Improved

Penalties cannot be appropriately administered unless IRS field personnel understand the penalty rules and IRS policies for administering penalties. This requires distribution of internal IRS guidance and training well before the effective date of the provision. Training materials and internal guidance should focus on differences in administration based on the type of taxpayer and industry, the policy reason for the penalty, and the relationship between that policy and the underlying substantive tax provision. Equal emphasis should be placed on training IRS personnel not to use penalties as a “lever” and on the skills necessary for dealing effectively with taxpayers and their representatives as is placed on not trading penalties and requiring a penalty adjustment that is separate from the underlying substantive tax adjustment. Examples of where internal IRS guidance and training could be improved include:

⁴⁴ See IRS Penalty Policy Statement 20-1 (June 29, 2004).

⁴⁵ Memorandum from Larry R. Langdon, Commissioner, Large and Mid-Size Business Division, to Large and Mid-Size Business Division Executives, Managers, and Examiners, dated December 20, 2001.

⁴⁶ See, e.g., Penalty Policy Statement 20-1; Memorandum from Robert L. Trujillo, Director, Planning, Quality, Analysis and Support, to All LMSB Industry Directors, Field Specialists, LMSB Headquarters Directors, dated April 13, 2008 (LMSB-04-0308-009); Memorandum from John Tuzynski, Chief, Employment Tax Operations, to Employment Tax Territory Managers, Group Managers, and Specialists, dated February 3, 2009 (SBSE-04-0209-008); Memorandum from W. Ricky Stiff, Chief, Excise Tax Program, to Excise Territory Managers and Program Managers, dated December 31, 2008 (SBSE-04-1208-068).

- The section 6694 penalty. This penalty was amended twice in as many years and its application demonstrates weaknesses in IRS training on new provisions. Although the IRS has taken steps to train employees in the revised penalty standards, anecdotal evidence indicates that many IRS employees in the field do not understand the rules or how to protect the preparer's section 6103 information from the taxpayer. In addition, despite a statement in the Preamble of the proposed preparer penalty regulations that the IRS intends to change the Internal Revenue Manual to eliminate the mandatory referral to the Office of Professional Responsibility (OPR) when a section 6694 penalty is asserted,⁴⁷ both the Large and Midsize Business Operation Division (LMSB) and the Small Business/Self-Employed Operating Division (SB/SE) issued memoranda requiring mandatory referral of section 6694 penalties to the OPR.⁴⁸
- The section 6676 penalty. This penalty is another example of a new provision where sufficient training has not been provided, resulting in inappropriate assertion of the penalty in the field. For section 6676 to apply in the first instance, the position on which the claim for refund is based must lack a reasonable basis. We are aware of section 6676 penalties being imposed automatically and regularly when a claim for refund is denied, without any consideration of whether the position has a reasonable basis. Some of this may be attributable to the fact that to date the IRS has not published regulations or other guidance with respect to section 6676. When such guidance is issued, procedures should be provided that enable taxpayers to challenge the penalty before it is actually assessed.

5. The IRS Should Increase Efforts to Educate Taxpayers and Tax Professionals

The IRS should help taxpayers and tax professionals understand penalties and related procedural rights, such as appeal rights and the ability to go to the Taxpayer Advocate for assistance. The IRS should issue clear, concise, and timely guidance when there are changes in laws or policies that impact penalties.

The IRS generally did an excellent job in providing timely guidance addressing the numerous changes to the section 6694 preparer penalty; however, more work is necessary.⁴⁹ For instance, estate and gift tax return preparers need guidance on how to apply new concepts such as disclosure, the "more likely than not" and "substantial authority" standards, and "tax shelter" to their practice, particularly since the IRS has recently stated that agents should evaluate whether the sections 6694 and 6695 penalties

⁴⁷ See REG-129243-07, 73 FR 34560 (6/17/2008).

⁴⁸ See SBSE-04-0209-008, *supra*, at footnote 46; LMSB -04-0308-009, *supra*, at footnote 46. A later memorandum issued by SB/SE dealing with estate and gift tax is more consistent with the language in the Preamble of the section 6694 proposed regulations. See SBSE-04-0509-009, *supra*, at footnote 35.

⁴⁹ See *supra*, footnote 46 and related text.

apply in their examinations.⁵⁰ It is unfair that there has been no guidance issued concerning how these rules impact estate and gift tax, and yet practitioners in this area are nonetheless subject to penalty.

The IRS should also consider additional outreach such as (1) publishing a summary of common penalties, including how to challenge each and the philosophy underlying each penalty; (2) leveraging existing outreach and liaison efforts to educate taxpayers and tax professionals on penalties, and (3) establishing a single point of contact for taxpayers and practitioners within the IRS to answer questions about penalties and how to troubleshoot case-specific issues. The IRS also could better use its website to provide penalty guidance by organizing guidance on penalties from the Servicewide Penalties Group on a single webpage similar to the way in which the OPR organizes its guidance on the IRS website.

III. Conclusion

This is a challenging time for taxpayers, tax advisors, and the government. While there are competing priorities and limited resources for change, we offer these ideas for reform of the civil tax penalty system because we believe they will further voluntary compliance with the tax laws and sound tax administration. We look forward to working with government officials and other stakeholders to address the issues highlighted in this report and improve our tax system.

⁵⁰ See SBSE-04-0509-009, *supra*, footnote 35.