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# The I.R.C. § 6751(b) Supervisory Penalty Approval Saga Continues


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01.31.2020

It's rare today that a taxpayer would receive a notice, report or a 30-day letter from the Internal Revenue Service without the assertion of some type of penalty. Frequently, an accuracy-related penalty under I.R.C. § 6662 is proposed against the taxpayer. Common grounds for the assertion of this penalty are negligence, disregard of rules and regulations, substantial understatement, and substantial valuation misstatement. Other penalties might involve the failure to timely file a return or a failure to timely pay the tax liability shown due on the return.

Can an auditor or revenue agent assert these penalties or others alone and without supervisory approval? Section 6751(b) generally requires supervisory approval of penalties at some point before assessment, but when exactly is that point? Since 2017, the Tax Court has grappled with this question and a litany of more particular unanswered related questions concerning the supervisory penalty approval statute of § 6751(b). In January of 2020 alone, the Tax Court issued three notable opinions addressing § 6751(b) that focused on: (1) when in the assessment process is the appropriate time for the IRS to comply with § 6751(b); and (2) whether Trust Fund Recovery Penalty (TFRP) assessments made under § 6672 are "penalties" subject to the supervisory approval requirements of § 6751(b).

## How Did We Get Here? [in brief]

Section 6751(b) states that "[n]o 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." In Graev v. Commissioner (Graev II), 147 T.C. 460, 475-76 (2016), the Tax Court held that supervisory approval could come at any time up until the day before assessment and still comply with § 6751(b)'s requirement that the approval be secured before assessment.

Chai v. Commissioner, 851 F.3d 190 (2d Cir. 2017) overruled this long-held belief and found that a minimum written supervisory approval of penalties needs to occur before the IRS sends a notice of deficiency to the taxpayer. The Tax Court subsequently adopted this approach and made it applicable to all deficiency cases in Graev v. Commissioner (Graev III), 149 T.C. 485, 500 (2017).

The holding in Graev III created a notable flurry of subsequent events: (1) the IRS issuing a plethora of updated internal guidance; (2) tax nerds scholars and practitioners generating hosts of thought leadership; and (3) tax practitioners consistently raising the supervisory penalty approval issue in previously unaddressed or unanswered contexts. Namely, when during the assessment process is the IRS required to comply with § 6751(b), and does § 6751(b) apply to penalties (or penalty-like provisions) assessed outside of notice of deficiency procedures. Two cases decided by the Tax Court in January address the "when" question, while the third addresses whether the "penalty-like" provisions of § 6672 are subject to § 6751(b).

## The January 2020 Tax Court Cases

In Belair Woods, LLC et al v. Commissioner, 154 T.C. No. 1 (Jan. 6, 2020), the IRS sent the Tax Matter Partner (TMP) of the partnership under examination a Letter 1807 inviting the TMP to a closing conference to discuss IRS Exam's proposed adjustments, which included disallowing a charitable contribution deduction for a conservation easement and alternative accuracy-related penalties under § 6662(c), (d), and (h). Two conferences were held, but no agreement was reached. After the conferences, the IRS agent finalized a penalty approval form (generally a Form 300 or 8278) asserting alternative accuracy-related penalties under § 6662(c), (d), and (h), which was then signed by the agent's immediate supervisor.

Then, IRS Exam issued a 60-day Letter disallowing the charitable contribution deduction and asserted the three penalties set forth in the executed penalty approval form. The TMP protested the determination, but IRS Appeals reached the same conclusion as IRS Exam. Appeals issued a Notice of Final Partnership Administrative Adjustment (FPAA) that mirrored the 60-day Letter and added a fourth penalty under § 6662(e). Supervisory approval of the penalty under § 6662(e) was not secured before the FPAA was issued.

At trial, the TMP argued that compliance with the penalty approval requirements of § 6751(b) needed to occur before the "first communication" to the TMP that the taxpayer might be subject to a penalty. In this instance, before the Letter 1807 was issued. The majority of the Tax Court rejected this argument and took a more practical approach, holding that as long as the matter is still within the control and discretion of IRS Exam, there is still time for supervisors to approve penalties. In other words, IRS Exam has to formally commit to proposed adjustments before the matter has moved past a point where the supervisor has discretion. In Belair Woods that line was the issuance of the 60-day Letter by IRS Exam because the issuance 60-day Letter was a "definite decision to assert those penalties, thus concluding the Examination Division's consideration of the case."

Given this, the Court found that the three alternative penalties approved before the issuance of the 60-day Letter were properly approved per § 6751(b), but that the § 6662(e) penalty asserted in the FPAA by Appeals was not properly approved.

In Tribune Media Company v. Commissioner, T.C. Memo. 2020-2 (Jan. 6, 2020), the IRS issued Notices of Proposed Adjustment (NOPAs) that proposed, but did not determine, penalties. After the NOPAs were issued, but before the notice of deficiency and FPAA were issued, the examining agent's immediate supervisor executed the applicable penalty approval forms. The taxpayer argued that supervisory approval must occur before the penalties are first proposed. The Court disagreed and applied the same reasoning used in Belair Woods, i.e., § 6751(b) does not require written supervisory approval of penalties until the first formal communication to the taxpayer that the IRS has determined a penalty. Here, the Court held that the first formal communications consisted of the notice of deficiency and the FPAA, and that the requisite supervisory penalty approval occurred before they were issued.

For more in-depth analysis of these two cases and the background leading-up to these decisions check out Professor Bryan Camp's post on the TaxProf Blog.

In Chadwick v. Commissioner, 154 T.C. No. 5 (Jan. 21, 2020), the Tax Court held that a TFRP asserted under § 6672 is a "penalty" within the meaning of § 6751(b) and thus subject to the requirement that written supervisory approval be secured for the "initial determination of such assessment." The Court further held that "initial determination" in this context was the Letter 1153 formally communicating the IRS's definitive decision to assert TFRPs against the taxpayer. Finally the Court found that the IRS satisfied the supervisory written approval requirement of § 6751(b).

Why is defining the TFRP as an actual penalty unusual? Well, long-established IRS policy, IRM pt. 1.2.1.6.3 (06-09-2003) Policy Statement 5-14 (Formerly P-5-60), has stated that despite the name, the TFRP under § 6672 is just an additional method to collect unpaid trust fund taxes (the employee portion of employment taxes) and not a penalty as employment taxes will only be collected once. Essentially, the TFRP is really just a separate tax liability imposed on responsible persons to help collect unpaid trust fund taxes. This policy has been acknowledged by courts as being a valid interpretation of § 6672.

Based on this long-standing policy and its embracement by various courts, the IRS Office of Chief Counsel took the position in Chief Counsel Notice 2018-006, after the holding in Graev III came out, that Chief Counsel attorneys should argue that written supervisory approval is not required in TFRP assessment situations. This position may now be in question due to Chadwick, but given how TFRP assessment procedures work, the magnitude of the Chadwick holding on day-to-day IRS activities and subsequent litigation may be minimal.

Professor Bryan Camp was all-over this case as well; get more background, details, and analysis here.

## The Take-Aways

1. Supervisory approval of a penalty must occur (and be documented) at a time before that initial determination, like a 30-day Letter, a Letter 1153, or possibly a notice of deficiency depending on the situation, "is embodied in a formal written communication to the taxpayer, notifying him that the Examination Division has completed its work and has made a definitive decision to assert penalties."
2. Penalty approval forms depend on the penalty asserted and the IRS Division asserting the penalty, and include, but are not limited to: Form 300 (Civil Penalty Approval Form); Form 8278 (Assessment and Abatement of Miscellaneous Civil Penalties); Form 4700 (for W&I/SBSE campus cases); Form 5772 (for TEGE cases); and Form 5809 (for preparer penalty cases).

3. So far, the Tax Court is a taking practical or pragmatic approach concerning the issue of "when" during the assessment process is the IRS required to comply with § 6751(b).
4. A TFRP asserted under § 6672 is a "penalty" within the meaning of § 6751(b) and thus subject to the requirement that written supervisory approval be secured for the "initial determination of such assessment."
5. The Tax Court, or at least Judge Lauber, is an employing a textualist approach to defining what constitutes a "penalty" within the meaning of § 6751(b).
6. Expect more § 6751(b) litigation in the Tax Court in the near future.
7. Compliance with the § 6751(b) supervisory approval requirements should be considered and evaluated during any examination where applicable penalties have been asserted.
8. Prior penalty assessments with open statutes of limitation should be reexamined and reevaluated to see if a § 6751 (b) issue could be raised through a refund claim or penalty abatement request.
9. Reach-out to David M. McCallum, Special Counsel and your Nexsen Pruet Tax Controversy Team concerning what to do with § 6751(b) issues or any IRS penalty issues.

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