

Area of Focus #8 **The Systemic First Time Abatement Policy As Currently Applied by the IRS Would Override Reasonable Cause Relief and Jeopardize Fundamental Taxpayer Rights**

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to a Fair and Just Tax System*

DISCUSSION

Currently, the IRS offers taxpayers who are subject to failure to file, failure to pay, or failure to deposit penalties a First Time Abatement (FTA) of those penalties, provided that taxpayers are in compliance and have not utilized the FTA within the last three years.² This abatement proceeds from a manual review that is triggered by a request from the taxpayer.

The First Time Abatement Provides an Important Mechanism for Penalty Relief

Occasionally, otherwise-compliant taxpayers make good faith mistakes regarding the filing of their tax return or payment of their tax obligations. Further, not all of these errors are eligible for the reasonable cause abatement provided by Internal Revenue Code (IRC) §§ 6651(a) and 6656(a).³ For instance, as discussed in the 2001 Annual Report to Congress:

A taxpayer mailed his 2000 return on April 15 with a check for \$200,000, which was in full payment of the balance due on his return. On April 20 the return was sent back to him for insufficient postage — the required postage was \$1.50, but he mistakenly put \$1.40 on the envelope. Subsequently he mailed the return with the required postage on April 21 but the tax return was deemed late. The taxpayer was assessed the failure to file penalty in the amount of \$10,000, as well as the failure to pay penalty.⁴

The National Taxpayer Advocate proposed the FTA to address just such situations where the error in question does not qualify for a reasonable cause abatement.⁵ Shortly thereafter, it was adopted by the IRS.⁶ Nevertheless, the IRS has implemented FTA so that it supplants, rather than complements, reasonable cause.

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Internal Revenue Manual (IRM) 20.1.1.3.3.2.1, *First Time Abate (FTA)* (Nov. 21, 2017).

3 Reasonable cause is generally available with respect to penalties for failing to file returns or pay or deposit taxes. IRC §§ 6651(a) and 6656(a). Nevertheless, this abatement is available only if taxpayers exercised ordinary business care and not willful neglect. Treas. Reg. §§ 301.6651-1(c), 301.6656-1.

4 National Taxpayer Advocate 2001 Annual Report to Congress 188 (Legislative Recommendations: *First Time Penalty Waiver*).

5 National Taxpayer Advocate 2001 Annual Report to Congress 188–192 (Legislative Recommendations: *First Time Penalty Waiver*).

6 Office of Servicewide Penalties (OSP), *Decision Document Regarding Whether to Continue to Apply First Time Abatement (FTA) Before Reasonable Cause; and Whether FTA Should Be Applied Systemically 1* (Jan. 30, 2018).

The First Time Abatement, As Currently Applied, Can Yield Inequitable Treatment of Taxpayers

If an FTA is requested, and if the taxpayer qualifies, the FTA will be automatically granted. The FTA is applied by the IRS, however, without first looking to see if the taxpayer might be eligible for a reasonable cause abatement.⁷ This rule of precedence, also known as “stacking,” is problematic because once the IRS grants an FTA, a taxpayer does not again become potentially eligible for another three years.⁸ In some situations, this stacking rule can result in disparate treatment of taxpayers.

For example, assume that a taxpayer files a late return in year one for reasons that would qualify for a reasonable cause abatement, as well as for the FTA. Assume further that in year three, the taxpayer is subject to a late payment penalty for reasons that do not meet the reasonable cause standards. In this scenario, the taxpayer would receive the FTA in year one but would be afforded no relief in year three.

By contrast, if the IRS considered reasonable cause, which is a *statutory* remedy, prior to application of FTA, the taxpayer would have received the reasonable cause abatement in year one. This approach would have preserved eligibility for the FTA over the next three years, thus enabling its use in year three against the failure to pay penalty. Moreover, this approach adheres to the *right to a fair and just tax system*, which means that taxpayers should have their tax liability determined based on the specific facts and circumstances of their particular case.

Automating Application of the FTA Is a Commendable Policy, If Done Correctly

The IRS Office of Servicewide Penalties is proposing to automate application of the FTA.⁹ This step would have some tangible benefits to both taxpayers and the IRS. It would likely result in the provision of an additional 1.35 million FTAs, yielding an extra \$261 million in annual abatements.¹⁰ Further, the IRS estimates that it would free up approximately 99-167 personnel who could be reallocated elsewhere.¹¹ In fact, use of the systemic FTA was first proposed by the National Taxpayer Advocate in 2010.¹² As a long-time proponent of this practice, the National Taxpayer Advocate applauds the IRS for exploring potential automation of this policy. The IRS must take care, however, to adopt the proper stacking rule so as to ensure that the automated FTA fully benefits taxpayers.

FTA Automation Should Not Be Implemented in a Way That Overrides Reasonable Cause Relief

As currently conceived, the IRS’s proposal for automating the FTA would continue to mandate the application of FTA over reasonable cause, even if a taxpayer had a clear-cut case in favor of reasonable cause relief. In effect, the proposed policy would write reasonable cause out of the law for the year in which the FTA was applied. It would violate taxpayers’ *right to pay no more than the correct amount of tax*, *right to challenge the IRS’s position and be heard*, and *right to a fair and just tax system*.¹³ Additionally,

7 IRM 20.1.1.3, *Criteria for Relief from Penalties* (Nov. 21, 2017). For the applicable law regarding reasonable cause, see Treas. Reg. §§ 301.6651-1(c), 301.6656-1.

8 OSP, *Decision Document Regarding Whether to Continue to Apply First Time Abatement (FTA) Before Reasonable Cause; and Whether FTA Should Be Applied Systemically 1* (Jan. 30, 2018).

9 *Id.*; see also Office of Chief Counsel Memorandum, POSTN-117216-17 (Sept. 28, 2017).

10 IRS, *Automatic First Time Abatement Proposal* (Nov. 3, 2017).

11 OSP, *Decision Document Regarding Whether to Continue to Apply First Time Abatement (FTA) Before Reasonable Cause; and Whether FTA Should Be Applied Systemically 5–6* (Jan. 30, 2018).

12 National Taxpayer Advocate 2010 Annual Report to Congress 202–204 (Most Serious Problem: *The IRS’s Over-Reliance on Its “Reasonable Cause Assistant” Leads to Inaccurate Penalty Abatement Determinations*).

13 IRC § 7803(a)(3)(C), (D), and (J).

the IRS would be elevating its own internally created remedy (*i.e.*, the FTA) over a statutory remedy created by Congress (*i.e.*, the reasonable cause abatement).

The IRS should develop systems that first consider eligibility for reasonable cause prior to automatic application of the FTA. While these systems are being put into place, or if they prove impracticable, the IRS could apply other policies that would continue to preserve primacy of the reasonable cause abatement. For example, the systemic FTA could be automatically applied, accompanied with the sending of a “soft letter” explaining the reasons for the abatement.¹⁴ Thereafter, those taxpayers believing they qualified for reasonable cause could present their cases to the IRS and, where eligible, could have reasonable cause applied in lieu of the FTA, thus preserving FTA as a future remedy.

The IRS has opposed this approach, however, arguing that it would require additional resources and would nullify some of the desired savings from adoption of the systemic FTA.¹⁵ Resource maximization, however, is not an acceptable justification for overriding taxpayer rights.

The IRS should implement the program in a way that is fair for all taxpayers and that allows the consideration of reasonable cause before the FTA is permanently applied. Such an adjustment would have an incremental cost to the IRS, but would result in a redesigned program of which the IRS could be proud, and that taxpayers could believe genuinely had their best interests at heart. Programs such as these develop trust in the tax system and reinforce the IRS’s legitimacy, which is crucial for the successful function of the voluntary tax system.¹⁶

FOCUS FOR FISCAL YEAR 2019

In fiscal year 2019, TAS will:

- Work with the IRS to develop a systemic FTA program that preserves reasonable cause as the primary mechanism for relief where taxpayers qualify;
- Collaborate with the IRS to establish training and policies targeted toward enabling personnel to more accurately evaluate and apply reasonable cause criteria in lieu of resorting to the FTA; and
- Advocate for taxpayers who receive an FTA when reasonable cause would have been applicable by entering into case-specific dialogues with Operating Divisions and issuing taxpayer assistance orders where appropriate.

14 National Taxpayer Advocate 2010 Annual Report to Congress 204 (Most Serious Problem: *The IRS’s Over-Reliance on its “Reasonable Cause Assistant” Leads to Inaccurate Penalty Abatement Determinations*).

15 OSP, *Decision Document Regarding Whether to Continue to Apply First Time Abatement (FTA) Before Reasonable Cause; and Whether FTA Should Be Applied Systemically* (Jan. 30, 2018).

16 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 7 (Research Study: *When do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*).