Penalty Abatement Basics & Techniques

An ebook companion to the popular webinar

by Tanya Baber, EA, & Canopy, Inc.

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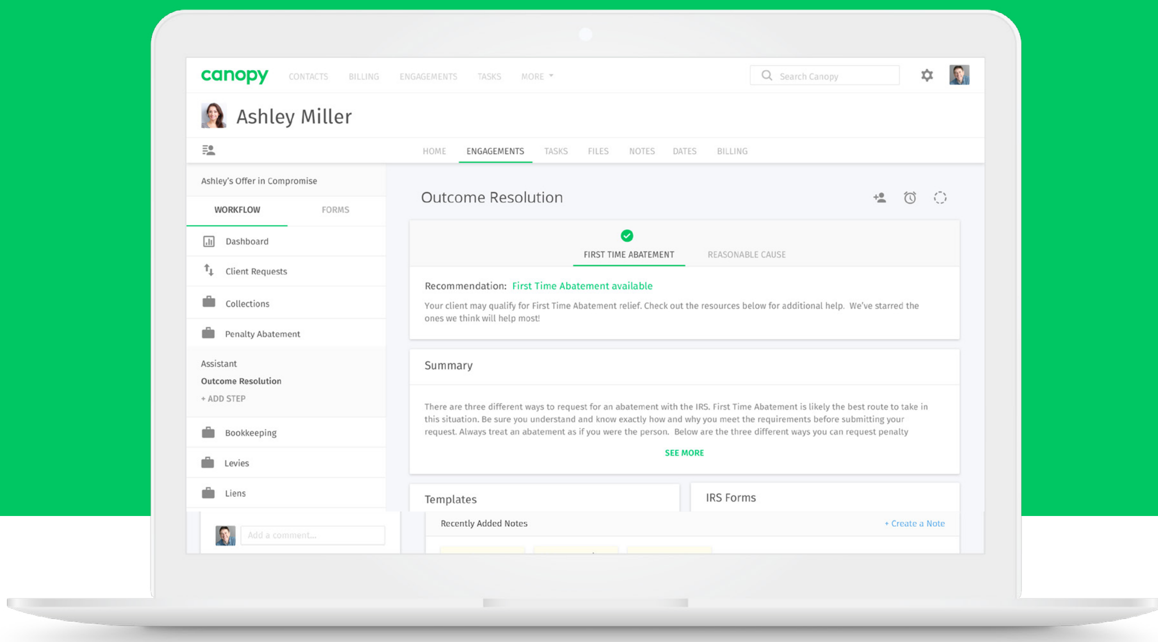

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Introduction

Like much of tax law, penalties can be overwhelming if a person is unfamiliar with their workings. If left unchecked, penalties can spiral out of control rapidly, adding tens of thousands of dollars (or more) of tax burden. Working with the IRS to abate penalties can be a complex, high stakes process, but this ebook is designed to arm you with a foundational knowledge of penalties and abatements. We'll cover:

- The two most common penalties—Failure to Pay and Failure to File.
- Interest on unpaid tax and how to reduce the total tax owed.
- First Time Abatement and five different categories of Reasonable Cause Abatement.

We've also provided a handy guide at the end of the book comprised of excerpts from the Internal Revenue Manual (IRM) covering each of the penalties and abatements we discuss in this book.

This ebook is not designed to be a comprehensive or authoritative commentary on tax law. Rather, it is designed as a companion to our Penalty Abatement Basics and Techniques webinar, both of which are intended to provide a basic overview of tax penalties and abatements to the best of our knowledge at the time of publication. Tax law is complex and changes frequently. None of the information in this book should be taken as a law without further consulting the most recent Internal Revenue Manual and other relevant legal references.

Penalties & Interest

Tax penalties are designed "to encourage voluntary compliance by supporting the standards of behavior required by the Internal Revenue Code," (IRM 20.1.1.2). In other words, they are intended to make non-compliance—neglecting to pay the right amount of taxes, on time, in the right way—more painful than paying voluntarily.

This section covers the two most common penalties—Failure to Pay and Failure to file—as well as interest on unpaid tax.

Failure to Pay

Failure to Pay (FTP) penalty is .5% per month, up to 25%.

The first and most common penalty is Failure to Pay. If taxes are not paid in full by their due date (generally the infamous April 15th), then the Failure to Pay penalty kicks in. The penalty is one half of one percent (.5%) of the unpaid balance, added every month or partial month the payment is late. That penalty will continue to grow until it either reaches the maximum 25%, or the balance is paid.

Examples

Danielle's Failure to Pay

> Danielle Duckberger owes $7,000 in taxes. She files a return but can only pay $2,000 at the time her taxes are due, and then $1,000 per month every month thereafter. By the time her taxes are completely paid, Danielle will have paid $75 in FTP penalties.

John's Failure to Pay for Six Years

> John Jellomonger owes $80,000 in taxes. He files his return but doesn't pay for six years. Assuming nothing more drastic happens to

> John, he will owe $20,000 in penalties in addition to his $80,000 tax bill.

Failure to Pay penalties aren't fun by anyone's definition of the word, but as you can see from Danielle's and John's examples, they don't have to be a big deal as long as they don't go unpaid for too long.

Failure to File

Failure to File (FTF) penalty is 4.5% per month, up to 22.5%.

The Failure to File penalty is another of the most common penalties. FTF applies, as the name suggests, when someone does not file a return by the required due date. The penalty is 4.5% of the unpaid tax per month. However, because a person cannot pay taxes without having filed a return, FTF is inevitably combined with a Failure to Pay penalty, making the effective penalty 5%.

FTF is obviously much more severe than Failure to Pay (9x to be exact), but it maxes out at 5 months, or 22.5%. Unlike the Failure to Pay penalty, which can be relatively mild if not left to fester, the Failure to File penalty becomes painful quickly. Additionally, if a taxpayer does not file their own return, the IRS will eventually file a Substitute For Return (SFR), which calculates taxes without accounting for deductions or exemptions. The result is owing far more tax than if a proper return had been filed.

Examples

Danielle Accrues FTP/FTF

> Danielle Duckberger figures she owes $7,000 in taxes but only has $2,000 when the deadline to file comes. Rather than filing her tax return on time, Danielle decides to wait until she has all $7,000. Five months later when she files her return, Danielle finds that she owes an additional $1,750 (25%) in combined FTF and FTP penalties.

John Maxes Out FTP and FTF

> John Jellomonger fails to file a return and makes no payments for six years. The IRS decides to take matters into their own hands and, after filing an SFR, determines that John owes $80,000 in taxes. Assuming the IRS lets it go that long without taking more emphatic measures, John has managed to max out both FTF and FTP penalties and will owe $38,000 (47.5%) in penalties in addition to his $80,000 tax bill.

As you can see, FTF penalties get expensive in a hurry.

Interest

Interest on unpaid tax is the current Federal Short Term Rate + 3%, compounded daily.

As if the penalties alone weren't enough, the IRS charges interest on unpaid tax. Interest is charged only on unpaid tax (not including any penalties the taxpayer has incurred).

Interest on unpaid tax is compounded daily, with a rate equal to the current Federal Short Term Interest Rate (determined quarterly) plus 3%. As of July of 2016, the combined interest rate for unpaid tax was 3.71%. Unlike the penalties we discussed above, interest is not eligible to be abated.

Partial Removal & Abatements

As noted in the previous chapter, the IRS is more interested in encouraging voluntary compliance than penalizing taxpayers. Partial removal and abatements are methods by which penalized taxpayers can reassert compliance, while also relieving their tax burden.

Partial Removals

This method isn't a true abatement like the others we will discuss shortly, but it can produce excellent results.

We talked earlier about the Substitute for Return, when, in the absence of a proper return, the IRS estimates a person's tax without taking into account any deductions or exemptions. The tax owed when calculated by the IRS will always be more than when a proper return is prepared by a competent tax professional. Because both interest and penalties are assessed as percentages of the unpaid tax, the penalties and interest will be overinflated as well. Similarly, a poorly prepared return can result in the taxpayer owing more tax than they should.

The solution is to file a proper, well-prepared delinquent or amended return. If the base tax can be reduced, both interest and penalties will necessarily reduce proportionally, making partial removals a good place to start most Tax Resolution cases.

Examples

Danielle Accrues Interest

> Danielle Duckberger waits until the last moment to start on her taxes. Because she's in a rush, she has her nephew's yoga instructor prepare her return. According to this hastily filed return, Danielle owes $16,000 in taxes. Though she only has $10,000 to pay her taxes at the time of filing, Danielle wisely decides to pay as much as she can.

> Unfortunately, she still starts receiving notices that she is accruing interest and penalties on her unpaid tax.
>
> After six months of worrying (and $292 in accrued interest and penalties), Danielle decides to have a competent tax professional give her return a second look. The competent tax professional files an amended return showing that Danielle actually owed only $12,000 in taxes, saving her a total of $4,195 in taxes, penalties and interest. Filled with joy and gratitude, Danielle pays the remaining $2,097 in unpaid taxes and fees.

John Files a Delinquent Tax Return

> John Jellomonger receives a notice in the mail that he owes $160,000 in taxes, six years overdue. Since he did not file a tax return, the IRS created a Substitute for Return to calculate his taxes, taking no deductions or exemptions into account. In addition to his tax, John owes $79,823 in interest and $57,000 in penalties for a total of $256,823.
>
> John immediately hires a tax lawyer to help him fix his IRS problem. The lawyer, in turn, files a well-prepared delinquent return showing that John actually only owes $80,000 in taxes. Though John still owes a painful $137,911 in taxes, interest and fees, filing the delinquent tax return saved him $118,912.

First Time Abatement (FTA)

First Time Abatement, or FTA, is a one time, get-out-of-jail-free card of sorts for abating certain penalties. The abatement is intended for taxpayers who are typically on top of their taxes but fell behind one year for any number of reasons. The IRS doesn't actually want to bury people who are typically good, responsible taxpayers.

Unlike Reasonable Cause Abatements we will talk about later, there isn't much room for interpretation with FTA. If the taxpayer meets the specific set of qualifications, they are eligible for the abatement—no need even for a good excuse. Because FTA is a one time deal you may want to look at other abatement options first, and be sure to use it on the most effective year.

There are three requirements for FTA:

1. FTA can abate three types of penalties—Failure to Pay, Failure to File, and Failure to Deposit.
2. The taxpayer must have at least three years of clean tax history immediately prior to the year they wish to use FTA—no penalties or noncompliance of any kind.
3. The taxpayer must currently be in compliance. This means having filed all required returns or a valid extension and paying or arranging to pay all taxes due.

Examples

Brooke Gets First Time Abatement

Unlike our previously cited tax delinquents, Brooke Bagelmeister has always been fastidious with her taxes—until this year. She scheduled a backpacking trip through China for the entire month of April (a reward to herself for an especially sweet financial year) and neglected to file a return before leaving. Taxes were the furthest thing from her mind when she came home as well, so when she received an intimidating notice from the IRS in October, she was caught entirely off guard.

With the help of a tax professional, Brooke hastily filed her return and paid the balance of her taxes—$65,000 this year—within a few days of receiving the notice. However, her accountant suggested that they may be able to get her an abatement for the FTF and FTP penalties, which he estimated at $16,575. Her accountant was correct, and because she has such a squeaky clean history as a taxpayer, Brooke was able to take advantage of First Time Abatement to have both penalties completely removed. Brooke's only financial penalty was roughly $1,200 in interest.

Danielle and John Do Not Get FTA

As you may have noticed by now, Danielle Duckberger and John Jellomonger are both very poor taxpayers. As they have a recent history full of tax penalties, neither has any chance of being granted an FTA.

Reasonable Cause Abatement

Reasonable Cause Abatements (RCA) are, in essence, when a tax professional approaches the IRS and says, “this taxpayer has a really good reason for not paying/filing their taxes on time.” Because Reasonable Cause situations are often multifaceted and complex, RCA can’t be quantified in the same way as FTA. However, this also means you have much more room for persuasion when trying to use Reasonable Cause in order to get penalties abated.

There are dozens of scenarios that can qualify as Reasonable Cause, and they often overlap, allowing you to cite several for a given scenario. The examples in this section are designed as an overview of Reasonable Cause considerations, not an exhaustive list. It would be a good idea to become familiar with section 20 of the IRM so you can reference specific sections and codes from the IRM directly whenever possible with the IRS. They have to input IRM-specific codes into their software as they evaluate each case, so the more precise you can be, the better.

This is also one of many areas where using Canopy to prepare a penalty abatement can be incredibly beneficial. Canopy is designed to keep track of all the relevant tax codes and apply them to each case, then suggest the most likely ways of abating a client’s penalties. Having software assist you through the complex abatement process saves you time without sacrificing accuracy.

The universal point that you will have to prove in any case of Reasonable Cause is what the IRS calls "ordinary business care and prudence." That phrase saturates section 20 of the IRM. When arguing for an RCA, the IRS will require proof that the taxpayer made a reasonable effort to meet his or her obligations. This effort will be a little different for each person and scenario, but establishing a taxpayer's effort to exercise ordinary business care and prudence will be central to any successful RCA.

Death, Serious Illness, or Unavoidable Absence

Death, serious illness, or unavoidable absence, applies only for the taxpayer and their immediate family—spouse, children, parents, siblings, grandparents, and grandchildren.

When looking at death, illness and absence as a reasonable cause, the IRS will consider the context of death, illness, or absence, as well as the overall effects of the same, such as:

- The dates, duration, and severity of an illness.
- The length of time after the death or absence the taxpayer is out of compliance.
- Any other financial hardships caused by the death, illness, or absence—unpaid bills and obligations besides the IRS.
- Ability to provide proof for all of the above as required.

Fire, Casualty, Natural Disaster, or Other Disturbance

Any major disaster or disturbance can potentially qualify as Reasonable Cause. This could include hurricanes, tornados, flooding, earthquakes, mud and landslides, riots, mass casualties, and more. If a client has a scenerio you think applies, give it a try. You can't get the abatement if you don't ask.

In these cases, proving care and prudence will likely include:

- The steps the taxpayer took to comply. Just giving up won't get you Reasonable Cause.
- Complying after the disturbance in a timely manner, as the taxpayer is able.
- Showing that the disaster caused other problems—financial hardship, inability to obtain records, death or serious injury, etc.

Sometimes specific procedures will be written for nationally declared disasters. Check with the IRS for incident-specific instructions in these cases.

Unable to Obtain Records

Records can be lost or unavailable for a number of reasons, from disasters like floods and fires, to negligence on the part of a third party. As with any Reasonable Cause Abatement, the IRS will want to know the steps taken toward ordinary business care and prudence by the taxpayer. In this case, that care and prudence will include:

- A good reason the records were unavailable. Were they lost in a fire or just in your attic?
- Attempts to recover the records. Obtain documentation for the attempts whenever possible.
- The taxpayer's attempt at compliance. Did the they make a reasonable estimate of tax owed or just give up?

IRS Error

If an IRS error caused penalties for a taxpayer, they are obligated to abate the penalty. The hard part about proving IRS Error is providing proof of the error. Written proof works best. If the error or bad advice was given orally, you need the ID number of the agent who gave the advice. The more clearly you can document the error, the better off you will be.

Financial Hardship

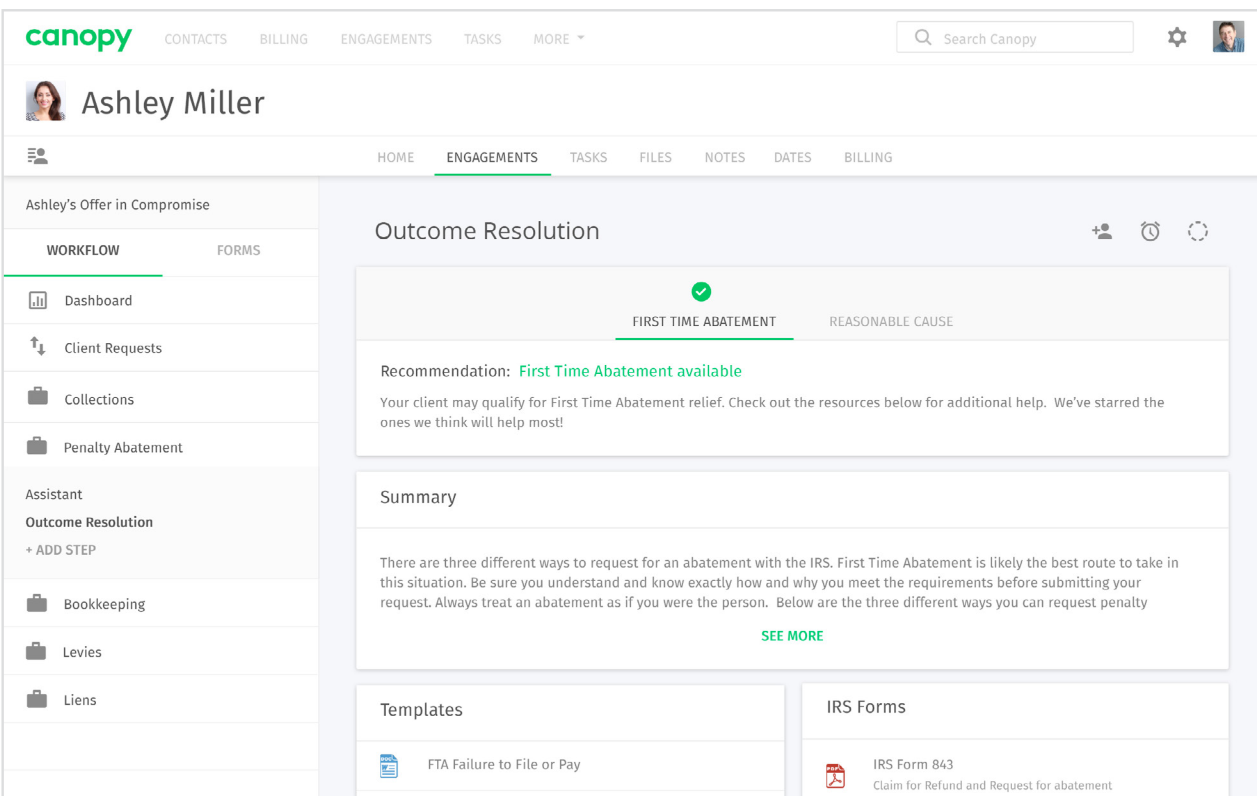
Substantial financial hardship can support an argument for FTP, but it has to be a real hardship—not just an inconvenience. As noted in the Death, Serious Illness, Unavoidable Absence section, the IRS doesn't look kindly on being the only one not getting paid. Proving hardship will require records—bank statements, bills, payments, and the like. Financial problems caused by vacation, remodeling a home, or even donating to charity don't qualify as hardship in the eyes of the IRS.

To show ordinary business care and prudence while claiming financial hardship, you will need to prove that the crisis immediately preceded the taxpayer's inability to comply and was both unexpected and financially devastating.

Resources

When it comes to penalty abatements, having the right tools is just as important as understanding the principles at work. Canopy's Tax Resolution software makes assessing penalty abatements intuitive and easy. Our smart survey helps you identify the specifics of each case, then our Service Assistant uses IRS standards to help you compare and select the best and most likely outcomes.

Sound simple? It is. [Try Canopy for free](), no credit card required.



Appendix I

IRM Excerpts—Penalties & Interest

Failure to Pay

8.17.7.4 (03-31-2014)
Failure to Pay Penalty, IRC 6651(a)(2) and IRC 6651(a)(3)

1. The Failure to Pay (FTP) penalties apply to the balance of tax due and shown on returns, and to balances due where notice and demand is given. In general, the applicable FTP penalty should be assessed at one-half of 1% of the unpaid tax for the first month the penalty applies and an additional one-half of 1% for each additional or fraction of the month the tax is unpaid, not to exceed 25% of the tax.
2. IRC 6651(a)(2):
   A. Computed from the date prescribed for payment of tax (determined with regard to any extension of time for payment.)

   B. Generally, the failure to pay penalty is computed from the original due date of the return to the date the tax is paid.
3. IRC 6651(a)(3)
   A. The IRC 6651(a)(3) penalty generally applies to the following additional assessments:
   • A deficiency, or
   • An amendment to the original return, or
   • Tax assessed due to the a correction of a mathematical error as defined under IRC 6213(b)(1).

   B. The IRC 6651(a)(3) penalty is assessed if payment is not made within 21 calendar days (or 10 business days if the balance due amount equals or exceeds $100,000) of notice and demand.
4. These additions under IRC 6651(a)(2) and IRC 6651(a)(3) will generally be assessed automatically by the Campus.
5. However, if the addition under IRC 6651(a)(2) relates to a "substitute return" (SFR) prepared by the IRS under IRC 6020(b), the deficiency procedures have to be followed before an assessment can be made.
6. If the taxpayer has filed a return and an additional tax liability is determined:
   A. The IRC 6651(a)(2) failure to pay penalty generally can't be asserted on a deficiency when the taxpayer filed a return. Therefore, the IRC 6651(a)(2) penalty should not be computed on the deficiency shown in the settlement computation when a return is filed by the taxpayer.

   B. However, if the Compliance report (RAR) or statutory notice of deficiency has asserted IRC 6651(a)(2) and the taxpayer filed a return, the AO or Counsel attorney will need to determine whether the IRC 6651(a)(2) penalty should be sustained or conceded.

   C. If the IRC 6651(a)(2) penalty is conceded, then the IRC 6651(a)(1) penalty asserted in the RAR or notice of deficiency will need to be recomputed.

   D. If an IRC 6651(a)(2) penalty was assessed, see *IRM 8.17.7.3.3* for information on how to recompute the IRC 6651(a)(1) penalty.
7. If the taxpayer has not filed a return and an additional tax liability is determined, see *IRM 8.17.7.5* for SFR procedures for computing the FTP penalty.

Failure to File

8.17.7.3 (09-24-2013)
Failure to File, IRC 6651(a)(1)

1. If a return is not timely filed, IRC 6651(a)(1) provides for a penalty of 5% if the failure is for not more than one month, with an additional 5% for each month or fraction thereof during which the failure continues, but not in excess of 25%.
2. The failure to file (FTF) penalty under IRC 6651(a)(1) applies to any delinquent return or substitute for return, except when the failure to file was due to reasonable cause and not willful neglect.
3. The FTF penalty is computed on the net amount due. The net amount due is the tax liability required to be shown on the return reduced by payments of tax on or before the date prescribed for payment and by the amount of allowable credits against the tax, which may be claimed on the return.
   A. If valid extensions of time to file have been granted, the FTF penalty is not applicable until the expiration of the extension and then only from that date on. An extension may be considered invalid if tax is not properly estimated. In these instances, the FTF penalty is computed from the original due date.
   B. To arrive at the tax liability required to be shown on return, compute the revised tax liability of the case, excluding all net operating loss, capital loss and credit carrybacks.
   C. All withholding credits are considered timely paid regardless of the posting date shown on the IDRS transcript. Additional withholding credits allowable are considered timely paid and are allowed as credits when computing the delinquency penalty.
   D. Refundable credits such as earned income credit, additional child tax credit, first time homebuyer credit, etc:
      1. Are treated as payments when computing the FTF penalty.
      2. Adjustments made to change these credits are not included in the revised tax liability.
      3. Instead, when computing the FTF penalty with adjustments to these credits, the revised tax liability as determined in paragraph (b) above is reduced by the **allowable** amount of these refundable credits.
      4. The "allowable" amount of refundable credit is the total amount shown on the transcript increased or decreased by any adjustments made to the refundable credit in the Appeals tax computation.
4. The FTF penalty is generally computer generated by the Campus with respect to the liability shown on delinquent returns.
5. Generally Appeals computations that assert the IRC 6651 penalty use the RGS penalty schedules or the TCS Excel penalty spreadsheets on the Technical Support SharePoint site, reached by a link on the TCS web site.
6. Interest will be imposed on the FTF penalty as of the return due date (including extensions.) The Campus will normally compute interest. If the taxpayer wishes to make a payment, then an interest computation will be requested by the AO and included in the case file.
7. Additional information on computing the FTF penalty can be found in IRM 20.1.2, *Failure To File/Failure To Pay Penalties*.

8.17.7.3.1 (03-31-2014)
Minimum Failure to File Penalty

1. If the return is at least 60 days late, including extensions, a minimum FTF penalty applies:
   - For returns due (without regard to extensions) after 12/31/2008, the minimum penalty is the **lesser** of $135 or 100 percent of the tax required to be shown on the return that was not paid on or before the due date.
   - For returns due (without regard to extensions) before 1/1/2009, the minimum penalty is the **lesser** of $100 or 100 percent of the tax required to be shown on the return that was not paid on or before the due date.
2. In order for the minimum penalty to apply, there must be a net tax due. Withholding and other allowable credits as of the due date of the return must be less than the revised tax liability or tax required to be shown on the return.
3. The minimum penalty applies only to income tax returns. It does not apply to employment tax, excise tax, gift tax, or estate tax returns.
4. When both the failure to pay (FTP) penalty and the minimum FTF penalty apply (income tax returns only), the minimum FTF penalty is not reduced by the amount of the FTP penalty.
5. See IRM 20.1.2.2.7.4, *Minimum Penalty*, for additional information.

Interest

20.2.1.4.2 (04-27-2016)
Rate

1. The interest rates on overpayments and underpayments of tax are established under IRC 6621, and are determined on a quarterly basis.
2. Notice 88-59, 1988-1 C.B. 546, announced that in determining the quarterly interest rates to be used for overpayments and underpayments of tax under IRC 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with IRC 6621 which, pursuant to IRC 6622, is subject to daily compounding.
3. Different interest rates apply to underpayments and overpayments, based on whether the taxpayer is an individual or corporation. The interest rates and their formulas are:

Overpayment Rates

Type:	**Applicable to:**	**Formula:**
Standard	Non-corporate overpayments	Federal short-term rate plus 3 percentage points
Corporate	Corporate overpayments	Federal short term rate plus 2 percentage points
GATT	Corporate overpayments exceeding $10,000.	Federal short term rate plus 0.5 of a percentage point

Underpayment Rates

Type:	**Applicable to:**	**Formula:**
Standard	Corporate and non-corporate underpayments.	Federal short-term rate plus 3 percentage points.
Large Corporate Underpayment	Underpayments of tax exceeding $100,000 by C-corporations.	Federal short-term rate plus 5 percentage points.

For additional information, see IRM 20.2.4.9, *Special Credit Interest Rules for Corporations*, and IRM 20.2.5.8, *Large Corporate Underpayment (LCU)*.

Appendix II

IRM Excerpts—Abatements

First Time Abatement

20.1.1.3.6.1 (08-05-2014)
First Time Abate (FTA)

1. RCA provides an option for penalty relief for the FTF (IRC 6651(a)(1), IRC 6698(a)(1), and IRC 6699(a)(1)); FTP (IRC 6651(a)(2) and IRC 6651(a)(3)); and/or FTD (IRC 6656) penalties if the following are true for the taxpayer:

   A. Has not previously been required to file a return or has no prior penalties (except the estimated tax penalty, TC 17X) for the preceding 3 years on the same MFT (except MFT 30/31, and see the exception for MFTs 01 and 14 in paragraph (5)(f)), and

   B. Has filed, or filed a valid extension for, all currently required returns and paid, or arranged to pay, any tax due.

      Example:

      Consider the taxpayer current if he or she has an open installment agreement and are current with his or her installment payments.

   Note:

   If the taxpayer is not currently in compliance per (1)(b) but all other FTA criteria are met, provide the taxpayer an opportunity to fully comply before considering reasonable cause.

   First-time abate (FTA) is an administrative waiver and does not carry any oral statement authority (OSA) dollar threshold. See *IRM 20.1.1.3.6.3* for additional OSA information. Also, FTA carries its own **PRCs**, **018** for non-RCA/manual look-back, or **020** for RCA being used to make the determination. See *IRM 20.1.1.3.6.2*.

2. A penalty assessed and subsequently reversed in full will generally be considered to show compliance for that tax period unless the exception in (5)(c) applies. RCA considers fully reversed penalties in its FTA analysis.

3. The FTA administrative waiver can only apply to a single tax period for a given MFT. For example, if a request for penalty relief is being considered for 2 or more tax periods on the same MFT and the earliest tax period meets FTA criteria, penalty relief based on FTA only applies to the earliest tax period, not all tax periods being considered. Penalty relief for all subsequent tax periods will be based on the showing of reasonable cause (and, as applicable, an absence of willful neglect).

4. The reasonable cause explanation provided by the taxpayer will be considered after RCA performs the FTA analysis. If FTA criteria does not apply based on reasons shown in (5) below, then the taxpayers explanation will be used to determine if reasonable cause penalty relief criteria is met (see Note in paragraph (1)). If the RCA determination is to abate the penalty(ies), penalty relief can be granted as appropriate per the RCA conclusion (i.e., reasonable cause, official disaster relief area, IRS error, Statutory and administrative waivers). Using the FTA analysis up front was based on a request from HQ Customer Accounts Services.

5. A FTA conclusion **WILL NOT** apply if any of the following criteria applies:

   A. Any tax period in the prior 3 years, for the same MFT (except MFT 30/31, and see the exception for MFTs 01 and 14 in paragraph (5)(f)), is in TDI Status 02 or 03, or IMF Status 04.

   B. An unreversed penalty for a significant amount (see *Caution* for an explanation of significant amount) is present (except the ES penalty) on any tax period in the prior 3 years, for the same MFT (except MFT 30/31, and see the exception for MFTs 01 and 14 in paragraph (5)(f)), and a notice was issued showing the assessed penalty(ies).

      Caution:

Reasonable Cause

20.1.1.3.2 (11-25-2011)
Reasonable Cause

1. Reasonable cause is based on all the facts and circumstances in each situation and allows the IRS to provide relief from a penalty that would otherwise be assessed. Reasonable cause relief is generally granted when the taxpayer exercised ordinary business care and prudence in determining his or her tax obligations but nevertheless failed to comply with those obligations.

2. In the interest of equitable treatment of the taxpayer and effective tax administration, the non-assertion or abatement of civil penalties based on reasonable cause or other relief provisions provided in this IRM must be made in a **consistent** manner and should conform with the considerations specified in the IRC, Treasury Regulations (Treas. Regs.), policy statements, and IRM Part 20.1, *Penalty Handbook*.

3. Reasonable cause relief is not available for all penalties; however, other exceptions may apply.

   A. For those penalties where reasonable cause can be considered, any reason which establishes that the taxpayer exercised ordinary business care and prudence, but nevertheless was unable to comply with a prescribed duty within the prescribed time, will be considered.

   B. If a reasonable cause provision applies only to a specific IRC section, that reasonable cause provision will be discussed in the IRM 20.1 section relating to that specific IRC section. See *Exhibit 20.1.1-1*, *Penalty Relief Application Chart*.

   C. When considering the information provided in the following subsections, remember that an acceptable explanation is **not** limited to those given in IRM 20.1. Penalty relief may be warranted based on an "other acceptable explanation," provided the taxpayer exercised ordinary business care and prudence but was nevertheless unable to comply within the prescribed time. See *IRM 20.1.1.3.2.2*, *Ordinary Business Care and Prudence*.

4. The wording used to describe reasonable cause provisions varies. Some IRC penalty sections also require evidence that the taxpayer acted in good faith or that the taxpayer's failure to comply with the law was not due to willful neglect. See specific IRM 20.1 sections for the rules that apply to a specific IRC penalty section. See *IRM 20.1.1.1.2, Organization of IRM 20.1*.

5. Taxpayers have reasonable cause when their conduct justifies the non-assertion or abatement of a penalty. Each case must be judged individually based on the facts and circumstances at hand. Consider the following in conjunction with specific criteria identified in the remainder of this subsection:

   A. What happened and when did it happen?

   B. During the period of time the taxpayer was non-compliant, what facts and circumstances prevented the taxpayer from filing a return, paying a tax, and/or otherwise complying with the law?

   C. How did the facts and circumstances result in the taxpayer not complying?

   D. How did the taxpayer handle the remainder of his or her affairs during this time?

   E. Once the facts and circumstances changed, what attempt did the taxpayer make to comply?

6. Reasonable cause **does not exist** if, after the facts and circumstances that explain the taxpayer's noncompliant behavior cease to exist, the taxpayer fails to comply with the tax obligation within a reasonable period of time.

Ordinary Business Care

20.1.1.3.2.2 (02-22-2008)
Ordinary Business Care and Prudence

1. Ordinary business care and prudence includes making provisions for business obligations to be met when reasonably foreseeable events occur. A taxpayer may establish reasonable cause by providing facts and circumstances showing that he or she exercised ordinary business care and prudence (taking that degree of care that a reasonably prudent person would exercise), but nevertheless were unable to comply with the law.

2. In determining if the taxpayer exercised ordinary business care and prudence, review available information including the following:

   A. **Taxpayer's Reason:** The taxpayer's reason should address the penalty imposed. To show reasonable cause, the dates and explanations should clearly correspond with events on which the penalties are based. If the dates and explanations do not correspond to the events on which the penalties are based, request additional information from the taxpayer that may clarify the explanation. See *IRM 20.1.1.3.2, Reasonable Cause*.

   B. **Compliance History:** Check the preceding tax years (at least three) for payment patterns and the taxpayer's overall compliance history. The same penalty, previously assessed or abated, may indicate that the taxpayer is not exercising ordinary business care. If this is the taxpayer's first incident of noncompliant behavior, weigh this factor with other reasons the taxpayer gives for reasonable cause, since a first- time failure to comply does not by itself establish reasonable cause.

   C. **Length of Time:** Consider the length of time between the event cited as a reason for the noncompliance and subsequent compliance. See *IRM 20.1.1.3.2, Reasonable Cause*. Consider: (1) when the act was required by law, (2) the period of time during which the taxpayer was unable to comply with the law due to circumstances beyond the taxpayer's control, and (3) when the taxpayer complied with the law.

   D. **Circumstances Beyond the Taxpayer's Control:** Consider whether or not the taxpayer could have anticipated the event that caused the noncompliance. Reasonable cause is **generally** established when the taxpayer exercises ordinary business care and prudence, but, due to circumstances beyond the taxpayer's control, the taxpayer was unable to timely meet the tax obligation. The taxpayer's obligation to meet the tax law requirements is ongoing. Ordinary business care and prudence requires that the taxpayer continue to attempt to meet the requirements, even though late.

Death, Illness & Absence

20.1.1.3.2.2.1 (11-25-2011)
Death, Serious Illness, or Unavoidable Absence

1. Death, serious illness, or unavoidable absence of the taxpayer, or a death or serious illness in the taxpayer's immediate family, may establish reasonable cause for filing, paying, or depositing late for the following:

   A. **Individual:** If there was a death, serious illness, or unavoidable absence of the taxpayer or a death or serious illness in the taxpayer's immediate family (i.e., spouse, sibling, parents, grandparents, children).

   B. **Corporation, estate, trust, etc.:** If there was a death, serious illness, or other unavoidable absence of the taxpayer (person responsible), or a member of such taxpayer's immediate family, and that taxpayer **had sole authority to execute the return, make the deposit, or pay the tax**.

2. If someone other than the taxpayer, or the person responsible, is authorized to meet the obligation, consider the reasons why that person did not meet the obligation when evaluating the request for relief. In the case of a business, if only one person was authorized, determine whether this was in keeping with ordinary business care and prudence.

3. Information to consider when evaluating a request for penalty relief based on reasonable cause due to death, serious illness, or unavoidable absence includes, but is not limited to, the following:

   A. The relationship of the taxpayer to the other parties involved.

   B. The date of death.

   C. The dates, duration, and severity of illness.

   D. The dates and reasons for absence.

   E. How the event prevented compliance.

   F. If other business obligations were impaired.

   G. If tax duties were attended to promptly when the illness passed, or within a reasonable period of time after a death or return from an unavoidable absence.

Fire, Casualty, Disaster

20.1.1.3.2.2.2 (08-05-2014)
Fire, Casualty, Natural Disaster, or Other Disturbance-Reasonable Cause

1. Determine if the taxpayer could not comply timely because the taxpayer was an "affected person" eligible for disaster relief as provided for in IRM 25.16.1.1, *Disaster Assistance and Emergency Relief-Overview*. Also see *IRM 20.1.1.3.3.6*, *Official Disaster Area*.
2. For taxpayers not considered an "affected person," reasonable cause relief from a penalty may be requested if there was a failure to timely comply with a requirement to file a return or pay a tax as the result of a fire, casualty, natural disaster, or other disturbance. However, one of these circumstances by itself does not necessarily provide penalty relief.
3. Penalty relief may be appropriate if the taxpayer exercised ordinary business care and prudence, but due to circumstances beyond the taxpayer's control, he or she was unable to comply with the law.
4. Factors to consider include the following:
    - Timing
    - Effect on the taxpayer's business
    - Steps taken to attempt to comply
    - If the taxpayer complied when it became possible
5. The determination to grant relief from each penalty must be based on the facts and circumstances surrounding each individual case. Determine if the event resulted in a circumstance for which other penalty relief criteria may apply. For example, if the taxpayer was unable to access his or her records as the result of a fire. See *IRM 20.1.1.3.2.2.3*, *Unable to Obtain Records*. If the taxpayer, or responsible party, was unable to comply because he or she was hospitalized as the result of an accident. See *IRM 20.1.1.3.2.2.1*, *Death, Serious Illness, or Unavoidable Absence*.

Unable to Obtain Records

20.1.1.3.2.2.3 (12-11-2009)
Unable to Obtain Records

1. Explanations relating to the inability to obtain the necessary records may constitute reasonable cause in some instances, but may not in others.
2. Consider the facts and circumstances relevant to each case and evaluate the request for penalty relief.
3. If the taxpayer was unable to obtain records necessary to comply with a tax obligation, the taxpayer may or may not be able to establish reasonable cause. Reasonable cause may be established if the **taxpayer exercised ordinary business care and prudence, but due to circumstances beyond the taxpayer's control, he or she was unable to comply.**
4. Information to consider when evaluating such a request includes, but is not limited to, an explanation as to the following:
    - Why the records were needed to comply.
    - Why the records were unavailable and what steps were taken to secure the records.
    - When and how the taxpayer became aware that he or she did not have the necessary records.
    - If other means were explored to secure needed information.
    - Why the taxpayer did not estimate the information.
    - If the taxpayer contacted the IRS for instructions on what to do about missing information.
    - If the taxpayer promptly complied once the missing information was received.
    - Supporting documentation such as copies of letters written and responses received in an effort to get the needed information.

IRS Error

20.1.1.3.3.4.1 (11-25-2011)
Written Advice From the IRS

1. The IRS is required by IRC 6404(f) and Treas. Reg. 301.6404–3 to abate any portion of any penalty attributable to erroneous written advice furnished by an officer or employee of the IRS acting in his or her official capacity.

2. If the taxpayer does not meet the criteria for penalty relief under IRC 6404(f), the taxpayer may qualify for other penalty relief. For instance, taxpayers who fail to meet all of the IRC 6404(f) criteria may still qualify for relief under reasonable cause if the IRS determines that the taxpayer exercised ordinary business care and prudence in relying on the IRS's written advice. See *IRM 20.1.1.3.2.2.5*.

3. Requests that qualify for penalty relief based on erroneous written advice from the IRS under IRC 6404(f) must be filed according to the following:

   A. Within the period allowed for collection of the penalty or addition to tax, or

   B. If the penalty or addition to tax has been paid, within the period allowed for claiming a credit or refund of such penalty or addition to tax.

20.1.1.3.3.4.2 (12-11-2009)
Oral Advice From IRS

1. The IRS may provide penalty relief based on a taxpayer's reliance on erroneous oral advice from the IRS. The IRS is required by IRC 6404(f) and Treas. Reg. 301.6404–3 to abate any portion of any penalty attributable to erroneous **written** advice furnished by an employee acting in his or her official capacity. Administratively, the IRS has extended this relief to include erroneous oral advice when appropriate.

2. In addition to considering the criteria provided in Treas. Reg. 301.6404–3, *IRM 20.1.1.3.3.4*, *Advice*, and *IRM 20.1.1.3.3.4.1*, *Written Advice From the IRS*, consider the following:

   A. Did the taxpayer exercise ordinary business care and prudence in relying on that advice?

   B. Was there a clear relationship between the taxpayer's situation, the advice provided, and the penalty assessed?

   C. What is the taxpayer's prior tax history and prior experience with the tax requirements?

   D. Did the IRS provide correct information by other means (such as tax forms and publications)?

   E. What type of supporting documentation is available?

3. The following is supporting documentation:

   A. A notation of the taxpayer's question to the IRS,

   B. Documentation regarding the advice provided by the IRS,

   C. Information regarding the office and method by which the advice was obtained,

   D. The date the advice was provided, and

   E. The name of the employee who provided the information.

Financial Hardship

20.1.1.3.3.3 (08-05-2014)
Undue Hardship

1. An undue hardship may support the granting of an extension of time for paying a tax or deficiency (i.e., Form 1127, *Application for Extension of Time for Payment of Tax Due to Undue Hardship*). Treas. Reg. 1.6161–1(b), provides that an undue hardship must be more than an inconvenience to the taxpayer. The taxpayer must show that he or she would sustain a substantial financial loss if **required to pay** a tax or deficiency on the due date.

   A. Undue hardship generally **does not** affect a person's ability to file and therefore would not provide a basis for penalty relief in a failure to file situation. However, each request must be considered on a case-by-case basis.

   B. Undue hardship may establish reasonable cause for failure to file on magnetic media under Treas. Reg. 301.6724–1. See IRM 20.1.7, *Information Return Penalties.*

2. The extension of time to pay does not provide the taxpayer with an extension of time to file. Nor does the extension of time to pay relieve the taxpayer of any appropriate penalties. See IRM 20.1.2.1.3.2, *Extensions of Time to Pay-IRC 6161*.

3. Undue hardship **may** also support relief from the addition to tax for failure to pay tax if the explanation for the noncompliance supports such a determination. However, the mere inability to pay **does not** ordinarily provide the basis for granting penalty relief. Under Treas. Reg. 301.6651–1(c), the taxpayer must also show that he or she exercised ordinary business care and prudence in providing for the payment of the tax liability.

   A. The taxpayer may claim that enough funds were on hand, but as a result of unanticipated events, the taxpayer was unable to pay the taxes.

   B. Consider an individual taxpayer's inability to pay a factor when considering penalty relief if the taxpayer shows that, had the payment been made on the payment due date, undue hardship (as defined in Treas. Reg. 1.6161–1(b)) would have resulted.

   C. In the case where a taxpayer files bankruptcy, consider inability to pay a factor if the insolvency occurred before the tax payment due date.

4. If payroll was met, taxes were withheld and should be available for deposit. Employers must reserve money withheld from employees' wages in trust until deposited. The employer should not use the money for any other purpose. Undue hardship does not support relief from the penalty under IRC 6672, *Failure to Collect and Pay Over Tax, or Attempt to Evade or Defeat Tax (Trust Fund Recovery Program).*

5. Information to consider when evaluating a request for penalty relief includes, but is not limited to, the following:

   A. When did the taxpayer know he or she could not pay?

   B. Why was the taxpayer unable to pay?

   C. Did the taxpayer explore other means to secure the necessary funds?

   D. What did the taxpayer supply in the way of supporting documentation, such as copies of bank statements?

   E. Did the taxpayer pay when the funds became available?

6. Use the appropriate PRC if penalty relief is warranted. See *Exhibit 20.1.1-2.*

Penalty Reference Chart

Exhibit 8.17.7-2
Penalty Reference Chart

IRC 6651(a) (1)	**Failure to File** 5% per month to 25% maximum. Based on correct tax liability less payments and credits allowable at due date of return.	All years.
	If the return is 60 days or more late, a minimum FTF penalty applies:	
	Minimum penalty is lesser of $135 or 100% of tax due on return.	Returns filed after 12/31/2008
	Minimum penalty is lesser of $100 or 100% of tax due on return.	Returns filed before 1/1/2009
	Interest accrues from later of return due date or extended DD.	
IRC 6651(a) (2)	**Failure to Pay** 0.5% per month not to exceed 25% in aggregate.	All years.
	Based on actual amount shown on return. Due date for payment is with regard to any extensions of time for payment.	
	FTP applies for SFR returns.	
	IRC 6651(d): See IRC 6651(d) and IRM 20.1.2.6 for certain situations where penalty is increased to 1%.	
	IRC 6651(h): See IRC 6651(h) and IRM 20.1.2.8 for certain situations where penalty is decreased to .25%.	
IRC 6651(a) (3)	**Failure to Pay Additional Assessment upon Notice and Demand** 0.5% per month not to exceed 25% in aggregate.	All years.
	Based on amount of additional assessment not paid on or before 21 calendar days from notice and demand (or 10 business days if amount of notice and demand equals or exceeds $100,000).	
IRC 6651(f)	**Fraudulent Failure to File** 15% per month up to maximum of 5 months, 75% maximum.	Returns due after 12/31/89, without regard to extensions.
	Amount of tax required to be shown on return reduced by tax timely paid and by credits which may be claimed on the day prescribed for payment of tax.	
	IRC 6662 and/or IRC 6663 can apply with IRC 6651(f) as long as a return is filed.	
	Carrybacks have no effect on penalty.	
IRC 6652(b)	**Failure to Report Tips** 50% of FICA tax on unreported tip income.	Returns due after 12/31/86, without regard to extensions
IRC 6654	**Failure to Pay Estimated Tax – Individual, Estates and Trusts** (See IRM 20.1.3.)	
IRC 6655	**Failure to Pay Estimated Tax – Corporation** (See IRM 20.1.3.)	
IRC 6656	**Failure to Deposit** (See IRM 20.1.4.)	
IRC 6662 - 20%	**Accuracy-Related Penalty** 20% of underpayment, applies to portion of understatement attributable to:	Returns due after 12/31/89, without regard to extensions.
	• Negligence	
	• Substantial understatement	
	• Valuation misstatement	
	• Overstatement of pension liabilities	
	• Estate/gift tax valuation understatement	
	• Transactions lacking economic substance	For transactions lacking economic substance, penalty applies for transactions entered into after 3/30/2010.
	Applies only if return has been filed.	
	Not applicable to fraud items.	
IRC 6662 - 40%	**Accuracy-Related Penalty** 40% of underpayment, applies to portion of understatement attributable to:	
	• Gross valuation misstatements.	Applies for returns due after 12/31/89.
	• Nondisclosed noneconomic substance transactions.	Applies for transactions entered into after 3/30/2010.
	• Any undisclosed foreign financial asset understatement.	Applies for tax years beginning after 3/18/2010.
	Applies only if return has been filed.	
	Not applicable to fraud items.	
IRC 6662A	**Accuracy-Related Penalty** 20% of the reportable transaction understatement.	Effective for taxable years ending after October 22, 2004.
	Increased to 30% for any portion of any reportable transaction understatement where the transaction was **not** properly disclosed	
IRC 6663	**Fraud** 75% of the underpayment attributable to fraud.	Returns due after 12/31/89, without regard to extensions.
	Applies only if return filed.	
	If no return filed, only IRC 6651(f) can apply.	