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PRACTICE POINT

Counterpoint: The IRS's First-Time Abatement Policy . . . Even Harsher Than You Realized

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I enjoyed reading Garrett Brodeur's practice point on the IRS's first-time abatement (FTA) policy. Over the years, I've successfully used the policy to obtain penalty abatement for many relieved clients who thought they would either be stuck paying exorbitant penalties for an innocent mistake, or forced to pay a tax advisor's hourly rates to navigate the lengthy and inefficient reasonable cause abatement process. As a longtime practitioner, I wanted to clarify a few misconceptions about FTA that may help practitioners.

First, while the IRS may broadly assert that FTA does not apply to late-filing penalties related to foreign information returns, the Internal Revenue Manual (IRM) provides otherwise. Specifically, IRM parts 20.1.9.3.5(3) and 20.1.9.5.5(3) explain that FTA may be applied to abate penalties assessed for the late filing of Forms 5471 and 5472 "if the failure to file penalty on the related Form 1120 [or Form 1065] filing is abated under … FTA … or would have been eligible for FTA abatement but a failure to file penalty wasn't assessed because there was $0 tax due or it was a fully paid return." For FTA to apply in such circumstances, the taxpayer must also demonstrate that no similar penalties were assessed during the three prior periods with respect to either the Form 5471 or 5472 itself or the Form 1120 or 1065 with which it was filed. Unfortunately, this relief does not apply to other foreign information returns such as Forms 926 or 8865, or the dreaded Forms 3520-A and 3520.

To obtain FTA relief for qualifying late-filed Forms 5471 and 5472, the taxpayer must generally request abatement in writing. In my experience, unlike "general" FTA relief, the IRS will not grant FTA relief for Forms 5471 or 5472 over the phone via the Practitioner Priority Service (PPS). Nonetheless, I generally recommend calling PPS in any event to review the taxpayer's IRS accounts and confirm that the taxpayer does, in fact, qualify for the relief. Often, taxpayers forget that they paid a very small failure to pay penalty at some point or did not realize that a penalty was assessed in the first place because it was satisfied by offsetting a refund owed to the taxpayer. Confirming the taxpayer's eligibility before requesting relief in writing can prevent the wrath of an angry client whose FTA request is denied because they were not eligible in the first place.

When requesting FTA relief for Forms 5471 and 5472, I find it helpful to cite the relevant portions of the IRM in the written abatement request. Given the commonly held misconception that FTA cannot apply to foreign information returns, it is often necessary to point the IRS to the exact IRM section that authorizes the requested relief. (For what it's worth, I recommend doing this even for routine FTA requests. Given that Appeals will usually decline to review FTA denials on the grounds that such relief is not statutory, but rather

a matter of administrative grace, there's good reason to make it as easy as possible for the Service Center reviewer to grant your FTA request in the first place.)

Another common misconception is that taxpayers can "save" FTA for a future year if they qualify for reasonable cause relief. Unfortunately, this is not the case. Even if a taxpayer presents a clear argument that reasonable cause relief should apply to remove an assessed penalty, the IRS Reasonable Cause Assistant (RCA) will usually first consider whether FTA applies before considering whether reasonable cause exists. If the FTA criteria are satisfied, the IRS will use FTA to abate the penalty and end their inquiry there. *See* IRM part 20.1.1.3.3.2.1(11) ("penalty relief under Administrative Waivers, including FTA, is to be considered and applied before reasonable cause. If FTA criteria are met, the FTA waiver will be applied before reasonable cause").

This is, of course, problematic for taxpayers, as the use of FTA in Year 1 will prevent a taxpayer from using FTA again until Year 5 at the earliest, as taxpayers need three years of no "unreversed" penalties before FTA can apply again. Unfortunately for taxpayers, FTA (*i.e.*, Penalty Reason Codes (PRC) 018 and 020) does not qualify as a "reversal" of a penalty in the same way that reasonable cause does. *See* IRM part 20.1.1.3.3.2.1(4) and IRM Exhibit 20.1.1-2. Consider two examples:

A. Taxpayer 1 files its 2019 Form 1120 late because the person responsible for filing the form has a serious medical emergency and is not in the office the week the return must be filed. The IRS (contrary to the IRM sections cited above) applies reasonable cause relief to reverse the penalty using PRC 026, a reasonable cause abatement code.

   Taxpayer 1 files its 2020 Form 1120 late because of a forgetful return preparer; no reasonable cause can be established. The IRS applies FTA using PRC 020. The prior year penalty does not prevent the application of FTA because it was reversed using PRC 026 and not an FTA code.

B. Same facts regarding filing, except the 2019 Form 1120 penalty was reversed using FTA, as provided in the IRM, even though reasonable cause existed. Taxpayer 1 will not qualify for FTA for the 2020 penalty because of the FTA code applied in 2019.

Practitioners have raised this seeming unfairness with the IRS many times in recent years. The IRS, however, has declined to change its practices on the basis that FTA is a matter of administrative grace – that is, something that taxpayers are not legally entitled to in any event. Stated otherwise, it is a gift from the IRS that removes penalties even in cases where no good reason existed. Much like the "get out of jail free" card in Monopoly, taxpayers should not count on FTA relief, and are not entitled to challenge its denial.

The flip side of FTA, which Mr. Brodeur's piece nicely points out, is that it *is* a time-saving freebie from the IRS that can save qualifying taxpayers penalties and the time and expense of hiring a practitioner to work through the reasonable cause process. Something to keep in mind the next time a client grumbles about not qualifying for FTA relief! ■