TAX PROCEDURE: THE ELEVENTH CIRCUIT SUSTAINS PENALTY DEFENSE BASED UPON AN ACCOUNTANT'S ADVICE

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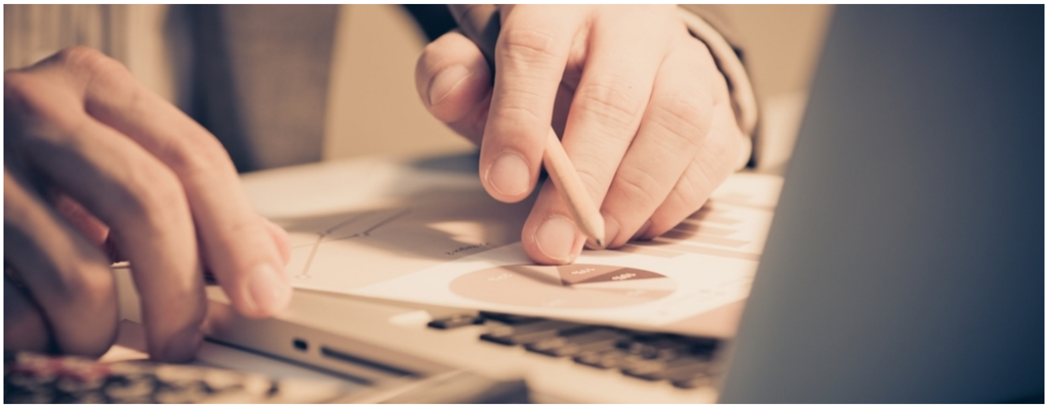


Taxpayers frequently rely upon an accountant to prepare their returns, and that involves more than just filling out forms. In preparing a return, an accountant will need to make judgments about the appropriate treatment of tax items, including whether income represents capital gain or ordinary income and whether expenditures should be capitalized or treated as business expenses.

If the IRS concludes that one of these judgment calls is incorrect, the taxpayer can be exposed to penalties, such as the accuracy-related penalty under section 6662 of the Internal Revenue Code. Taxpayers frequently point to the accountant's role in an effort to avoid liability for the penalty; the Code provides a defense where the taxpayer shows that that there was "reasonable cause" for the position taken on the return and that she acted in good faith. I.R.C. § 6664(c)(1). While that sounds like an easy standard to satisfy, the reported decisions are decidedly mixed, as each case turns on its facts. On September 12th, the Eleventh Circuit overturned a Tax Court decision that refused to sustain the good faith/reasonable cause defense. *Boree v. Comm'r*, No. 14-15149 2016 U.S. App. LEXIS 16682 (11th Cir. Sept. 12, 2016).

Mr. Boree had acquired a large tract of undeveloped land and was planning to develop it. *Id.* at *3-*4. After encountering a variety of obstacles, Mr. Boree sold the land to another developer. *Id.* at *8-*9. When he and his wife filed their tax return, the gain on the sale of the land was listed as a capital gain. *Id.* at *11-*12. This was done despite the fact that in prior years the taxpayers' returns had treated the land as inventory held for sale as part of a trade or business; the couple had also deducted operating expenses associated with the property as business expenses instead of capitalizing them. *Id.*

The IRS assessed Mr. Boree and his wife with a substantial deficiency that reflected its conclusion that the income from the sale of the real estate was properly treated as ordinary income. The IRS also assessed a penalty due to a substantial underpayment of tax under section 6662(b)(2) of the Code. *Id*. at *12. The Tax Court sustained both determinations, and on appeal, the Eleventh Circuit sustained the Tax Court's determination that the income was ordinary income, not capital gain.

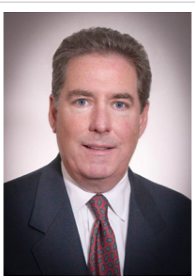
The Court of Appeals parted company with the Tax Court on the issue of the penalty, however, overturning the determination that the accuracy-related penalty was properly assessed. The court commenced its analysis by observing that the question whether a taxpayer had reasonable cause for a position on a tax return and acted in good faith called for a consideration of "all pertinent facts and circumstances." *Id.* at *32 (quoting Treas. Reg. § 1.6664-4(b)(1)). Reliance on professional advice, along with the taxpayer's education and business experience, were factors that the Eleventh Circuit identified as relevant. *Id*. at *32-*33.

On the merits, the court held that the taxpayers had demonstrated that there was a reasonable basis for the position on the return and that they had acted in good faith. The Court of Appeals cited a variety of factors:

- First, it noted that Mr. Boree was "a former logger with no accounting experience." *Id*. at *34.
- Second, the court noted that Mr. Boree had a long relationship with the accounting firm that prepared the return, which enjoyed a strong reputation due to the fact that its principal served as a tax professor at the University of Florida's law school. *Id*.
- Boree had testified that she and her husband had never had any reason to question the firm's tax advice. *Id*. at *34-*35.
- The Borees had provided all of their information to an employee of the firm, who was described as "detail-oriented." The court viewed this as an indication that Mr. and Mrs. Boree had made a good faith effort to assess their tax liability correctly. *Id*. at *35.
- Nothing was withheld from the accounting firm, and no false information was provided.

While the relevant return claimed both business expenses and capital gain from the same activity, the Eleventh Circuit held that "it was reasonable for the Borees, who were untrained in tax matters, to have relied in good faith on that decision." *Id.*

This is a taxpayer-friendly ruling that rests, in large measure, on the court's recognition that Mr. and Mrs. Boree were not sophisticated.



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