

### **Listed Transactions: Section 6707A Penalties and Assessment Limitations Period.**

Section 6707A of the Internal Revenue Code imposes a substantial penalty on taxpayers who fail to disclose their participation in tax avoidance transactions when they file their return. Specifically, if the taxpayer fails to include “any information with respect to a reportable transaction” required to be disclosed under Section 6011 of the Code, then a penalty of 75% of the tax savings from the transactions applies, subject to statutory minimums of \$5,000 for individuals and \$10,000 for entities and maximums of up to \$100,000 for individuals and \$200,000 for entities. I.R.C. § 6707A(a), (b). Regulations issued under Section 6011 of the Code fill in the details; among the ways a taxpayer can incur the penalty is to fail to disclose participation in a “listed transaction,” which is a transaction that is identical or substantially similar to a transaction that the IRS has previously identified as a tax avoidance scheme in published guidance. *See* Treas. Reg. § 1.6011-4(b)(2).

There is also a special limitations period for listed transactions; while the IRS normally has three years to assess taxes and penalties, under Section 6501(c)(10) of the Code, the IRS can impose the penalty under Section 6707A within one year of disclosure of the relevant transaction by either the taxpayer or a material advisor.

A recent case considered this penalty regime and its limitations period in an interesting context: the question was whether a Form 872 waiver of the assessment limitations period also covered the special period for listed transactions under Section 6501(c)(10). *May v. United States*, 2015 U.S. Dist. LEXIS 76962 (D. Ariz. June 15, 2015). The *May* case involved a taxpayer who had a listed transaction that he failed to disclose on his 2004 tax return. Mr. May did not acknowledge his failure to disclose this transaction until September 26, 2011. *May*, 2015 U.S. Dist. LEXIS 76962, slip op. at \*1-\*2.

The taxpayer had signed two Forms 872 and provided them to the IRS agent conducting an audit of his returns: the first provided that “any amount of Federal Income & Excise Tax” for the 2003 and 2004 tax years could be assessed at any time up to December 31, 2011, while the second provided that “the amount of any IRC Section 6707A penalty” relating to any returns for the 2005 and 2006 tax years could be assessed at any time up to December 31, 2011. *Id.*, slip op. at \*2-\*4. Moreover, the revenue agent involved in preparing the waivers later testified that when she intended a waiver to address the limitations period for the Section 6707A penalty, she spelled that out specifically. *Id.*, slip op. at \*3.

Subsequently, the deadline to impose a Section 6707A penalty for the 2005 and 2006 tax years was extended to September 30, 2012, in a waiver signed in May 2011. *Id.*, slip op. at \*4. Finally, in June 2011, a different revenue agent obtained a waiver of the limitations period that permitted assessment of “any amount of Federal Income and Excise Tax” due for tax years 2003-2006 at any time up to December 30, 2012. *Id.*, slip op. at \*4.

In March 2010, the government issued a thirty day letter advising the taxpayer that it planned to assess the Section 6707A penalty for the transaction that was omitted from his 2004 return, but it did not issue the actual assessment until February 6, 2012. *Id.*, slip op. at \*5. May paid the penalty and sought a refund administratively; thereafter he brought a refund action in district court. In light of the March 2010 thirty day letter, the government conceded that it had all information necessary to assess the penalty more than one year prior to the actual assessment date. *Id.*, slip op. at \*5.

The district court resolved the case on the basis of competing summary judgment motions, ruling in the taxpayer's favor.

*First*, the *May* court rejected the government's contention that the one year limitations period had not begun to run because Mr. May never filed the requisite Form 8886 with the IRS. The court rejected this contention based on the plain language of Section 6501(c)(10), which focused on tax returns that lack the requisite "information." *Id.*, slip op. at \*7-\*9. In the court's view, the IRS had one year from the date when it was furnished with the required "information" to assess the penalty; given the March 2010 thirty day letter, the court readily determined that the IRS had waited more than a year from receipt of the required information to assess the penalty, which meant the assessment was not timely. *Id.*, slip op. at \*13.

*Second*, the court rejected the government's alternate argument that the relevant limitations period was extended through the execution of waivers on Form 872. Here, the court applied contract principles, which are relevant because Section 6501(c)(4) requires that the parties reach an agreement on the extension, which is "a manifestation of mutual assent." *May*, 2015 U.S. Dist. LEXIS 76962, slip op. at \*13 (quoting *Kelley v. Comm'r*, 45 F.3d 348, 350 n. 4 (9th Cir. 1995)). The court concluded that there was no mutual assent because different Form 872s were signed on the same day and the two forms distinguished between "Income & Excise Tax" and the Section 6707A penalty. *Id.*, slip op. at \*14. Since there was no valid extension of the assessment limitation for the Section 6707A penalty for the relevant tax year, the assessment was untimely and the taxpayer prevailed.

Jim Malone is a tax attorney in Philadelphia; he focuses his practice on federal, state and local tax controversies. This post is intended to provide background on a relevant issue; it is not intended as legal advice. © 2015, MALONE LLC.