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Tax Court: Notice of deficiency included 20% penalty, complied with section 6751

The U.S. Tax Court today—in a “reviewed opinion”—determined that the taxpayers were liable for a 20% penalty under section 6662(a) with the disallowance of their claimed charitable contribution deductions relating their claimed donations of a façade easement.

The Tax Court majority concluded that the notice of deficiency included the 20% penalty as required by section 6751(a), and that the IRS was not barred from assessing this penalty because of a lack of proper written approval for assessment of the penalty, as required by section 6751(b)(1). The majority held that the notice of deficiency complied with section 6751(a).

The case is: *Graev v. Commissioner*, 147 T.C. No. 16 (November 30, 2016). Read the Tax Court’s 106-page [decision](#) [PDF 355 KB] that includes both concurring and dissenting opinions.

Background

The taxpayers (husband and wife) claimed on their 2004 income tax return a charitable contribution deduction for the donation of a facade easement on their residence in New York, and claimed on their 2005 return a carryover of a portion of that deduction.

The IRS examining agent determined to disallow the claimed charitable contribution deductions and also initially determined that determined that the taxpayer were liable for the 40% gross valuation misstatement penalty.

The IRS agent prepared a penalty approval form for which he obtained written approval from his immediate supervisor, and on that form only the 40% penalty under was asserted. A notice of deficiency that included the 40% penalty was prepared.

However, before the notice of deficiency was issued, an IRS Chief Counsel attorney reviewed a draft of the deficiency notice. The Chief Counsel attorney, through a memorandum approved by his supervisor, advised that an alternative 20% penalty under should be added to the notice of deficiency. Accordingly, the notice of deficiency was then revised to include the alternative 20% accuracy-related penalty (setting out the calculation to yield a “zero” 20% penalty to avoid stacking with the 40% penalty—i.e., the notice of deficiency calculated the full 40% penalty and a zero 20% penalty).

The revised notice of deficiency was issued, but with no further approval from the examining agent’s supervisor.

In this litigation, the IRS previously conceded liability for the 40% penalty, but continues to assert the alternative 20% penalty as a non-zero amount. The taxpayers countered that the IRS had failed to comply with the requirements of section 6751 as to the alternative 20% penalty—that (1) a computation of the penalty must be included in the notice of deficiency; and (2) the initial determination of the penalty assessment must be personally approved (in writing) by the agent’s “immediate supervisor * * * or such higher level official as the Secretary may designate.” The taxpayers asserted that these procedural failures blocked the assessment of the 20% penalty.

Section 6751(b)(1) provides:

*No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination * * *.*

Tax Court’s opinion

The majority found that the notice of deficiency complied with section 6751(a), and that because the IRS had not yet assessed any 20% penalty (the IRS cannot assess the penalty until the decision of the Tax Court is final), the claim that the IRS had failed to comply with section 6751(b)(1) was “premature.”

The court sustained the 20% accuracy-related penalty for a substantial understatement of income tax for 2004 and 2005.

Eight judges joined in Judge Thornton's opinion; three concurred in its result; and Judge Gustafson dissented, with four judges joining in the dissent and concluding that they would strictly and narrowly interpret the language contained in section 6751(b)(1).

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