

The Pressure Is On: Penalties and Penalty Abatement

By Karen Tenenbaum and Stelios Karatzias



A taxpayer who has been noncompliant with their tax obligations will ordinarily find their tax liability to be greater than the actual taxes owed. The main source of this increased assessment stems from two additional factors imposed by the Internal Revenue Service and New York State; the first is accrued interest and the second is penalties. A process known as a penalty abatement can alleviate the pressure of the penalties.



What Can Trigger Penalties?

The IRS and NYS consider the following actions to justify the enforcement of penalties:

- Failing to file a tax return,
- Failing to pay on time,
- Failing to deposit certain taxes as required,
- Other penalties as applicable

The purpose of implementing penalties is to encourage compliance and expedite the taxpayer's resolution of their outstanding liability. The IRS and NYS believe that taxpayers will take proactive steps to avoid an increasing balance.

What Is a Penalty Abatement?

A penalty abatement is the forgiveness of penalties and penalty interest a taxpayer has accumulated on their tax returns. In circumstances where a penalty abatement is approved, the taxpayer is still obligated to pay their underlying tax liability and any accrued interest but will be absolved of abated penalties.

Who Qualifies for Relief?

The IRS recognizes three main classifications for penalty abatement.

- An IRS Administrative Waiver and First Time Penalty Abatement is offered to taxpayers who did not have a previous obligation to file or have not been subject to a penalty for the three preceding tax years. Additionally, the taxpayer must be compliant with all required returns and have either paid or arranged to pay any tax due. Note that NYS does not have a first time penalty abatement.
- A penalty abatement under Reasonable Cause is for taxpayers who can demonstrate they have reasonable cause for failing to meet their tax obligation. The IRS and NYS identify many grounds that would provide sound reasons for noncompliance including fire, casualty and natural disasters; inability to obtain records; death, serious illness, or injury to either the taxpayer or an immediate family member; or any other reason that would establish that a taxpayer used all ordinary business care and prudence to meet their tax obligation but was unable to do so.
- An IRS Statutory Exception allows abatement of any penalties where the taxpayer has relied upon the erroneous written advice of the IRS. When requesting relief, the taxpayer may need to provide proof of their written request for advice, the erroneous written advice they relied on that was furnished by the IRS, and the report, if any, of tax adjustments identifying the penalty or addition to tax, and the item(s) relating to the erroneous advice. NYS has a similar provision.

Conclusion

The application of penalties by the IRS or NYS helps ensure tax compliance. However, in appropriate cases, both agencies are willing to grant penalty abatement to qualified taxpayers. As a result, it is essential for tax practitioners to be aware of the rules governing penalty abatement and provide the appropriate documentation to the IRS or NYS in order to limit clients' tax liability.

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