SECTION 6676 ERRONEOUS CLAIM FOR REFUND OR CREDIT PENALTY: THE PENALTY HAS NO REASONABLE BASIS[1]

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I. OVERVIEW OF CURRENT LAW

A. Section 6676

On May 25, 2007, President Bush signed into law the Small Business and Work Opportunity Tax Act of 2007[3] (the "2007 Act"), which enacted §6676 of the Internal Revenue Code.[4] New §6676 penalizes taxpayers for denial of certain income tax refund claims filed after May 25, 2007. Section 6676 imposes a new civil penalty equal to 20% of the "excessive amount," unless the refund claim for the excessive amount has a reasonable basis. An "excessive amount" is defined as the difference between the amount sought in the claim, and the amount of the claim actually allowed.[5] Thus, a

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[3] HR 2206, U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, P.L. 110-28 (May 29, 2007), 110th Congress.

[4] Unless indicated otherwise, all references to "section" or "§" are to the Internal Revenue Code of 1986, as amended and currently in effect (the "Code"), and all references to "Treas. Reg. §" are to the Treasury Regulations promulgated under the Code.

[5] Section 6676 specifically provides:

> SEC. 6676 ERRONEOUS CLAIM FOR REFUND OR CREDIT.
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> 6676(a) CIVIL PENALTY. --If a claim for refund or credit with respect to income tax (other than a claim for a refund or credit relating to the earned income credit under §32) is made for an excessive amount, unless it is shown that the claim for such excessive amount has a reasonable basis, the person making such claim shall be liable for a penalty in an amount equal to 20 percent of the excessive amount.
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> 6676(b) EXCESSIVE AMOUNT. --For purposes of this section, the term "excessive amount" means in the case of any person the amount by which the amount of the claim for refund or credit for any taxable year exceeds the amount of such claim allowable under this title for such taxable year.

disallowed refund claim, or any portion thereof without a reasonable basis, is subject to penalty equal to 20% of the disallowed amount. The statute does not define what "reasonable basis" is for this purpose. The penalty does not apply to any portion of the excessive amount that is subject to the accuracy-related or other penalties under part II of subchapter A of chapter 68 of the Code, or that relates to the earned income tax credit under §38. No defenses or procedures are set forth in the Internal Revenue Code.

The Joint Committee Summary regarding §6676 does not provide sufficient, or clear, information to understand Congress' intent in enacting the penalty. In the description of the "Present Law", the Joint Committee Summary does not address any issues with respect to filing erroneous refund claims, or claims for excessive credits. Rather, the Present Law explanation addresses the imposition of the accuracy-related penalty to cases involving substantial or gross valuation misstatements.[6] An accuracy-related penalty applies to *underpayments* of tax relating to *original returns*. While legislative history explains very little about the impetus to enact §6676, the new penalty provision was introduced as a revenue raiser, as part of the Iraq funding bill. In theory, §6676 could raise revenue by assessing the penalties on disallowed claims, and reduce the amount of refunds granted by deterring taxpayers from filing claims.

After defining the present law regarding accuracy-related penalties and valuation misstatements, the Joint Committee Summary's "Explanation of Provision"—imposing a penalty on taxpayers filing erroneous claims for refund or credit[7]—is a *non sequitur*.

> 6676(c) COORDINATION WITH OTHER PENALTIES. --This section shall not apply to any portion of the excessive amount of a claim for refund or credit which is subject to a penalty imposed under part II of subchapter A of chapter 68.

[6] Joint Committee on Taxation, Technical Explanation of the Small Business and Work Opportunity Tax Act of 2007 May 25, 2007 (JCX-29-07). The Present Law description provides:

> Present law imposes accuracy-related penalties on a taxpayer in cases involving a substantial valuation misstatement or gross valuation misstatement relating to an underpayment of income tax. Sec. 6662(b)(3) and (h). For this purpose, a substantial valuation misstatement generally means a value claimed that is at least twice (200 percent or more) the amount determined to be the correct value, and a gross valuation misstatement generally means a value claimed that is at least four times (400 percent or more) the amount determined to be the correct value.
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> The penalty is 20 percent of the underpayment of tax resulting from a substantial valuation misstatement and rises to 40 percent for a gross valuation misstatement. No penalty is imposed unless the portion of the underpayment attributable to the valuation misstatement exceeds $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). Under present law, no penalty is imposed with respect to any portion of the understatement attributable to any item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return and there is a reasonable basis for the tax treatment. Special rules apply to tax shelters.

[7] Joint Committee on Taxation, Technical Explanation of the Small Business and Work Opportunity Tax Act of 2007, May 25, 2007 (JCX-29-07). Specifically, the Explanation of Provision provides:

> The provision imposes a penalty on any taxpayer filing an erroneous claim for refund or credit. The penalty is equal to 20 percent of the disallowed portion of the claim for refund or credit for which there is no reasonable basis for the claimed tax treatment. The penalty

With only this limited, unclear, legislative history, §6676 was enacted and immediately became effective for claims for refund or credit filed after May 25, 2007. Prior to the 2007 Act, there was no applicable penalty imposed on a disallowed, non-frivolous refund claim.

B. Refund Claims Generally

The principal function of a claim for refund is to put the government on notice that the taxpayer believes that tax has been overpaid, and to describe the basis upon which the taxpayer relies. Under Treas. Reg. §301.6402-2(b)(1), a claim for refund must include each ground upon which a credit or refund is claimed, and facts sufficient to apprise the Commissioner of the exact basis thereof. The filing of a claim for refund gives the Internal Revenue Service (the "IRS") an opportunity to examine the taxpayer's assertions and to determine whether there has been an overpayment. Further, the filing of a refund claim is a prerequisite to bringing a suit for refund in the U.S. district courts or the U.S. Court of Federal Claims (hereinafter the "Claims Court").[8]

Typically refund claims are filed with the IRS Center serving the state where the taxpayer's original return was filed. Upon receipt, the IRS Center will review the refund claim to determine whether the: refund claim was timely; claim is based on an assertion of the unconstitutionality of the Internal Revenue laws; taxpayer waived the right to a refund in having the IRS compromise a tax liability; or the refund claim relates to a return closed pursuant to a closing agreement or a final order of a court. If any of these circumstances are found, the IRS Center will generally issue a letter to the taxpayer stating that no consideration can be given to the claim.[9] If a refund claim does not involve any of these circumstances, it is referred to an Examiner for further review.

If upon review, an Examiner determines that the claim should not be allowed, the Examiner will send a letter (Letter 569) and a report to the taxpayer proposing either partial or full disallowance of the claim. Letter 569 provides that if the taxpayer does not agree with the Examiner's findings, the taxpayer may request a meeting or conference call with the Examiner's supervisor.[10] Further, if the taxpayer still does not agree with the determination, the taxpayer may request a conference with the Appeals Office either by letter or by submitting a formal protest (depending on the refund claim amount).[11]

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does not apply to any portion of the disallowed portion of the claim for refund or credit relating to the earned income credit or any portion of the disallowed portion of the claim for refund or credit that is subject to accuracy-related or fraud penalties.

8 IRC §7422(a).

9 See, Letter 569 (DO) (Rev. 9-2000).

10 *Id.*

11 *Id.*

II. SUPPORT FOR REPEAL OF SECTION 6676

A. Section 6676 Should Be Repealed as the Burdens in Imposing a Penalty Far Outweigh the Benefits.

Although Congress' intent in enacting §6676 is unclear, communication with the IRS by the authors regarding §6676 have raised the following issues that may have prompted the enactment of §6676: (i) numerous frivolous or "bad" refund claims; (ii) limited IRS resources to review refund claims; and (iii) the IRS' timing disadvantage *vis-à-vis* the taxpayer on a refund claim if, in reviewing the refund claim, the IRS finds erroneous items (unrelated to the refund claim) on the return that are not assessable because the period of limitations has expired.

While each of these concerns is valid, these issues are or can be addressed by other Code provisions. Even if current Code provisions are not sufficient to address these issues, §6676 is not the appropriate solution as the burdens of imposing the penalty far outweigh the intended benefits.

1. Other Code provisions adequately address IRS concern regarding numerous frivolous or "bad" refund claims or other Code provisions could be amended to address these concerns.

There are several Code provisions that address, or can be amended to address, the issues of numerous frivolous or "bad" refund claims. For example, §6702 imposes a penalty of $5,000 to any taxpayer who, with a desire to delay or impede the administration of Federal tax laws or with a frivolous position, files a return that fails to contain information from which the correctness of reported tax liability can be determined or that clearly indicates that the tax liability shown must be substantially incorrect. In *Tickel v. United States*, the court held that a §6702 civil penalty for filing a frivolous income tax return applies to a refund claim.[12]

Section 6702 was recently amended to impose a penalty to "specified frivolous submissions." A "specified frivolous submissions" includes: a request for a hearing under §6320 (relating to notice and opportunity for hearing on filing of a notice of lien); a request for Collection Due Process ("CDP") hearing under §6330 (relating to notice and opportunity for hearing before levy); an application under §6159 (relating to agreements for payment of tax liability in installments); an application under §7122 (relating to compromises); or an application under §7811 (relating to taxpayer assistance orders).[13] Section 6702 could be amended to include a frivolous refund claim as one of the specified submissions.

From communication with the IRS by the authors regarding §6676, the IRS seeks to discourage the filing of "bad" refund claims. These "bad" refund claims may be facially reasonable (e.g., a taxpayer making a claim for refund based on bogus withholdings or deductions). Thus, arguably a §6702 frivolous penalty would not be

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12 *Tickel v. United States*, 623 F. Supp. 218 (E.D. Tenn. 1986).

13 IRC §6702(b)(2)(B).

applicable.[14] These are legitimate concerns that need to be addressed.[15] However, these "bad" refund claims are at most criminal and should be punished under §7207. At a minimum, filing a "bad" refund claim reflects a desire to delay or impede the administration of Federal tax laws. Thus, if §6702 was amended to include a refund claim as a specified submission, a §6702 penalty could be imposed on these "bad" refund claims. The IRS has already imposed a §6702 penalty on claims for refund.[16] As enacted, §6676 will not result in the intended benefit (as identified herein) to the IRS.

Further, §6673(b) allows the courts, other than the Tax Court, to impose a penalty up to $10,000 if it appears to the court that the taxpayer's position in a proceeding is frivolous or groundless.

Enacting a separate penalty provision applicable only to a claim of refund is not an effective solution to treat frivolous refund claims.

2. Internal Revenue Service resources.

A part of the concern about numerous frivolous refund claims, relate to the limited IRS resources to review claims. However, to administer new §6676, the IRS will have to allocate additional resources, and time, to review not only the basis for the refund claims, but also whether any denied portion is based on a reasonable basis. Reasonable basis will most likely be based on some type of legal authority, therefore; the IRS will have to review the legal authority to make the reasonable basis determination. Further, if the IRS imposes a §6676 penalty, in all likelihood the taxpayer will challenge—either administratively or judicially—the imposition of the penalty. Thus, the IRS will have to allocate additional resources and time to deal with the taxpayer's challenge. Accordingly, enforcement of §6676 will put an additional drain on IRS resources and result in no benefit to the IRS.

3. Statute of limitations issues regarding erroneous item discovered by the IRS in review of the refund claim.

The Government's concern that it has a timing disadvantage *vis-à-vis* the taxpayer on a refund claim, because the IRS may find erroneous items (unrelated to the refund

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[14] Because generally refund claims do not have an underpayment, the accuracy-related provisions of §6662 and the §6663 fraud penalty are also not applicable. However, if the IRS issued a refund and the Government filed an action for recovery of an erroneous refund, there would be an underpayment subject to §§6662 or 6663.

[15] The National Taxpayer Advocate shares the government's general interest in protecting the public fisc and urges the IRS to do all that is reasonable to prevent fraudulent refund claims from being paid out. The IRS's Criminal Investigation (CI) administers the Questionable Refund Program (QRP), which culls through millions of refund claims filed by taxpayers each year to identify claims with questionable data elements. National Taxpayer Advocate's Report to Congress --Fiscal Year 2008 Objectives (June 30, 2007).

[16] See *Tickel v. United States*, 623 F. Supp. 218 (E.D. Tenn. 1986); *Harper v. United States*, 587 F. Supp. 1056, 1059 (D. Pa. 1984) (Court notes that the IRS' notices denying a taxpayer's claim for a refund stated taxpayer showed a desire to delay and/or impede the administration of federal tax law.).

claim) on the return that are not assessable due to the expiration of the period of limitation for that year, is unwarranted.

First, if the "erroneous item" on the original return relates to a 25% or greater omission of gross income, the IRS can assert that the six-year statute of limitations under §6501(e) applies. Further, if the "erroneous item" relates to a listed transaction, the IRS has one year from the date the taxpayer or promoter meets the information requirements in §6501(c)(10). Lastly, if the "erroneous item" is so egregious that the original return is considered false or fraudulent, or a willful attempt to evade tax, the statute of limitations to make an assessment does not expire.[17] In fact, §6501(c) addresses numerous exceptions to the three-year limitations period on assessment. Most likely a refund claim will have to be filed within the three years from the date the original return was filed.[18] Consequently, under the extended limitations periods identified in §6501(c) the IRS can review and make an assessment with respect to the original return.

Second, if the period of limitations to assess additional tax based on an erroneous item on an original return has expired, the Government can raise the issue as a setoff defense, by including it in its answer or amended answer, in a suit for refund. Even though the period of limitations to assess additional tax has expired, a taxpayer cannot prevail if the Government successfully raises new issues to defeat the refund claim.[19]

Lastly, the authors are of the view that the expiration of the period of limitations to assess on the original return, is not a disadvantage to the IRS sufficient to warrant enactment of §6676. The IRS has three years from date of a return is filed to examine a return and assess additional tax.[20] Congress has determined that this is sufficient time. If the IRS needs additional time to review a return, then the solution to this issue should be an amendment to the limitations period specified in §6501. The solution to this issue should not be to penalize or deter taxpayers from filing refund claims.

The authors would also like to note, it is highly likely a majority of low income taxpayers who file refund claims, do not deliberately wait until shortly before the period of limitation on assessment on the original return expires to file their claims. Taxpayers who have the financial means to obtain professional tax advice, however, are more likely to wait until shortly before the period of limitation on assessment on the original return expires to file their refund claims in order to foreclose a potential examination or assessment. Accordingly, the IRS' purported disadvantage only applies to taxpayers who have the financial means to obtain professional tax advice regarding the filing of their refund claims. These taxpayers would also have the financial means to retain tax professionals to ensure that the positions taken in their refund claims have reasonable basis. Thus, unsophisticated taxpayers, or taxpayers who cannot afford professional tax

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17 IRC §6501(c)(1), (2).

18 See, IRC §6511(a).

19 See, *Lewis v. Reynolds*, 284 U.S. 281 (1932) (Government can claim the setoff defense because in a refund suit the taxpayer must prove that he overpaid the tax in order to prevail). But see, *Patterson v. Belcher*, 302 F.2d 289 (5th Cir. 1962) (a setoff is merely available to reduce or eliminate the refund claimed by the taxpayer but may never give rise to a judgment in favor of the Government).

20 IRC §6501(a).

advice, will bear the brunt of §6676, as well as additional assessments on their original returns.

There may be Constitutional challenges to the imposition of the penalty, which will further increase the costs and burdens to the IRS, and the taxpaying public. These potential Constitutional issues raised by a §6676 penalty may include: penalizing a taxpayer for merely seeking a refund; having a chilling effect on taxpayers' right to seek refunds; raising a barrier to a taxpayer's right to file a refund suit in either the district courts or the Claims Court; and/or imposition of a penalty that is substantially disproportionate to the harm caused. However, these Constitutional issues are not analyzed in this Paper.

Lack of IRS resources to review refund claims, or timely examine an original return, should also not be a basis for penalizing taxpayers. From the discussions with the IRS, by the authors, it appears that the IRS is concerned with frivolous or fraudulent claims for refund. Other Code provisions already address, or can be amended to address, these types of refund claims.

B. Section 6676 Does Not Serve the Purpose for Which Penalties are Imposed.

The Internal Revenue Manual ("IRM") provides that the purpose of penalties is to encourage voluntary compliance by: (1) defining standards of compliant behavior; (2) defining remedial consequences for noncompliance; and (3) providing monetary sanctions against taxpayers who do not meet the standard. "These three factors support the public conviction that the tax system is fair and *the penalty is in proportion to the severity of the noncompliance*."[21] While courts have held that with respect to penalties on deficiencies, the amount of the penalty is proportionate to the amount of the taxpayer's deficiency and the cost to the government in collecting the deficiency,[22] this rationale is not applicable to a §6676 penalty.

A §6676 penalty can be so substantial that it will not be in proportion to the severity of the noncompliance. There is a considerable difference between a 20% penalty on a $1,000,000 deficiency and a 20% penalty on *asking* for a $1,000,000 refund. In the former, the IRS is without the funds and must spend time and money in determining whether a liability exists and subsequently collecting the tax. In the later, the IRS already has the funds so no effort is spent on collecting the tax. Further, the time spent by the IRS in determining whether the taxpayer is entitled to some or all of the refund claimed must be spent regardless of whether the claim for refund claim is excessive. Thus, the time and effort in denying a refund claim is not as substantial as the time and effort in collecting the tax.

Section 6676 may have the opposite effect on compliance than what was intended by Congress (i.e., §6676 will discourage taxpayer compliance in remitting taxes). Prior to enactment of §6676, there was strategic advantage for taxpayers to reserve tax

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21 IRM 20.1.1.2 – Purpose of Penalties (8-20-1998) (emphasis added).

22 See, e.g., *Thomas v. Comm'r*, 62 F.3d 97 (4th Cir. 1995).

positions for which there was less than a compelling level of authority to amended returns as there was no penalty for these positions taken in good faith, and, outside of a potential criminal sanction for filing false claims, there was little consequence for positions taken in bad faith. If a taxpayer has essentially the same exposure to civil penalties whether the position is taken on an original return or on an amended return, then the taxpayer will most likely take the position on the original return on the theory that the population of original returns is greater than the population of amended returns. Thus, the IRS will have to spend more resources culling through the original returns to find these "positions" that used to jump out of a much smaller pool of amended returns. The end result will be that the IRS will spend more resources chasing the same group of taxpayers as before, but most likely with less success. Thus, §6676 may discourage taxpayer compliance and it may be a net revenue loser because less tax may be paid with original returns.

The authors are cognizant of the fact that the Government is trying to encourage the taxpayer to both pay the tax and refrain from filing a refund claim for positions that the IRS deems to have less than a "reasonable basis." However, some taxpayer will want to challenge a position, and of the two choices, it is in the Government's best interest to encourage the taxpayer to pay the tax and subsequently file a refund claim, than to not pay the tax and challenge an assessment.

Section 6676 will be costly to administrate, it does not serve the purpose for which penalties are assessed, and it is not in the best interest of tax administration. Based on the foregoing, the burdens of §6676 far outweigh its benefits. Accordingly, it should be repealed.

III. SUPPORT FOR CLEAR GUIDANCE IN THE FORM OF TREASURY REGULATIONS AND REVENUE PROCEDURES ARE NECESSARY

Section 6676 was enacted without any guidance or clear intent by the Legislation. In its current form, §6676 leaves open many questions including: the standard of "reasonable basis"; potential application of the reasonable cause and good faith exception; procedures for imposing the penalty and administrative appeal rights; timing of the imposition of the penalty; and judicial review procedures if the penalty is imposed. Clear guidance in the form of Treasury regulations and revenue procedures needs to be published on these issues. Further, the IRS should provide transitional relief to apply to all amended returns and refund claims until guidance addressing these issues is provided.

A. The "Reasonable Basis" Standard.

Proposal: *The IRS should define "reasonable basis" to have the same meaning as the phrase has under Treas. Reg. §1.6662-3(b)(3). Further, Forms 1040X and other amended income tax forms, Form 1045, and the related Instructions to these forms need to be updated to inform taxpayers that §6676 penalties can apply to a disallowed refund claim unless reasonable basis exists and to define reasonable basis.*

If a refund claim (or any portion thereof) has been denied and it had a "reasonable basis", the §6676 penalty does not apply (to that portion). The statute, however, does not

define what is meant by "reasonable basis". For purposes of accuracy-related penalty, Treas. Reg. §1.6662-3(b)(3) exempts penalties on the portion of underpayment attributable to negligence if the position is properly disclosed on the return and the position has a "reasonable basis." These regulations provide that the reasonable basis standard is:

> [A] relatively high standard for tax reporting, that is, significantly higher than not frivolous or not patently proper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. If a return position is reasonably based on one or more of the authorities set forth in Treas. Reg. 1.6662-4(d)(3)(iii)(taking into account the relevance and persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard even though it may not satisfy the substantial authority standard as defined in §1.6662-4(d)(2). … In addition, the reasonable cause and good faith exception in §1.6664-4 may provide relief from the penalty for negligence or disregard of rules or regulations, even if the return position does not satisfy the reasonable basis standard.[23]

The types of authorities taxpayers may rely on for "reasonable basis" prescribed by Treas. Reg. §1.6662-4(d)(3)(iii) are:

- Applicable provisions of the Code and other statutory provisions;
- Proposed, temporary and final regulations construing such statutes;
- Revenue rulings and revenue procedures;
- Tax treaties and regulations thereunder, and Treasury Department and other official explanations of such treaties;
- Court cases;
- Congressional intent reflected in committee reports, joint explanatory statements of managers included in conference committee reports, floor statements made prior to enactment by one of a bill's managers;
- General Explanations of tax legislation prepared by the Joint Committee on Taxation (the Blue Book);
- Private letter rulings and technical advise memoranda issued after March 12, 1981 (as well as general counsel memoranda published in pre-1955 volumes of the Cumulative Bulletin);
- IRS information or press releases; and
- Notices, announcement and other administrative pronouncement published by the IRS in the Internal Revenue Bulletin.

Conclusions reached in treatises, legal periodicals, legal opinions or opinions rendered by tax professional are not legal authorities. Most practitioners view that a taxpayer has reasonable basis if he has approximately a 20-25% chance of succeeding on the merits if challenged by the IRS.

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[23] Treas. Reg. §1.6662-3(b)(3) (emphasis added).

The IRS should define "reasonable basis" as used in §6676 to have the same meaning as the phrase has under Treas. Reg. §1.6662-3(b)(3) because the accuracy-related penalty regulations already provide a clear definition of reasonable basis.

B. Reasonable Cause and Good Faith Exception.

Proposal: *Section 6676 should be amended to provide for reasonable cause exception as defined in Treas. Reg. §1.6664-4.*

Unlike other penalty provisions, §6676 does not provide for a reasonable cause exception. The purpose of civil tax penalty is to encourage voluntary compliance, which includes filing accurate returns.[24] Section 6676 penalty should encourage and accomplish that, but should not penalize taxpayers who acted in good faith and who acted reasonably under the circumstances.

While the reasonable basis standard set in Treas. Reg. §1.6662-3 is fairly clear, it requires a taxpayer to consult a tax professional to know that a position is based on a permissible legal authority and that the position is reasonably based on one or more such authorities. Imposing this standard without allowing for reasonable cause exception will favor taxpayers with financial means to obtain professional tax advice over taxpayers without such financial means. Taxpayers without the means to obtain professional advice will unfairly be exposed to §6676 penalties.

In general, civil tax penalty provisions provide for reasonable cause exceptions. For example, delinquency penalty provisions (failure to file and failure to pay) provide that if a taxpayer is able to show that the failure is due to reasonable cause, and not willful neglect, delinquent penalties do not apply.[25] In this regard, if the taxpayer exercised ordinary business care and prudence, and was nevertheless unable to file the return within the prescribed period, then the delay was due to a reasonable cause.[26]

Additionally, §6721 imposes a penalty for filing a return with incorrect/missing taxpayer identification numbers and name; however, the penalty is waived upon showing that the failure was due to reasonable cause and not willful neglect. Reasonable cause can be established if taxpayer acted in responsible manner both before and after the failure occurred, and there were significant mitigating factors or failure was due to events beyond the taxpayer's control.[27]

Further, the §6662 accuracy-related penalty does not apply with respect to any portion of an underpayment, if there was reasonable cause and the taxpayer acted in good faith.[28] The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances, the most important factor being the extent of the taxpayer's efforts to

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[24] IRM 20.1.1.2 – Purpose of Penalties (08-20-1998).
[25] IRC §§6651(a)(1) and (2).
[26] Treas. Reg. §1.6651-1(c)(1).
[27] IRS Publication 1586 (Rev. 09-2007), pg 2.
[28] IRC §6664(c)(1).

assess her proper tax liability. An honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge and education of the taxpayer may indicate reasonable cause and good faith. Further, an isolated computational error is not inconsistent with reasonable cause and good faith.[29] Finally, reliance on an information return, professional advice or other facts constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith.[30]

Section 6676 in its current form would discourage voluntary compliance when punishing taxpayers that acted reasonably and in good faith. Regulations should be drafted that allow for reasonable cause and good faith exception to §6676. The reasonable cause exception should be determined based on all of the facts and circumstances, the most important being the extent of the taxpayer's efforts to assess her proper tax refund. An honest misunderstanding of fact or law that is reasonable in light of the experience, knowledge and education of the taxpayer should indicate reasonable cause and good faith. Further, reasonable reliance on a professional advice should indicate reasonable cause, if the advice was reasonable and the taxpayer provided all relevant facts to the tax professional.

C. Procedures for Determining Whether to Impose a §6676 Penalty.

There are numerous questions that to be answered regarding the procedures the IRS will use in determining whether to impose a penalty under §6676. The authors propose that the IRS provide clear guidance either in the form of revenue procedures or temporary regulations on how it will assess the penalty and what administrative procedures are allowed for taxpayers to contest the penalties.

1. Will a determination to impose a §6676 penalty be based solely on the information provided in the taxpayer's claim for refund or will the IRS contact the taxpayer in order to make a determination of whether there is reasonable basis? Further, will the taxpayer be given an opportunity to present additional information?

Proposal: *Guidance should provide that the IRS is required to contact the taxpayer to allow her an opportunity to address the issue of whether a position taken in a refund claim has a reasonable basis prior to the imposition of a §6676 penalty. Moreover, guidance should provide that the taxpayer may provide additional information to support that her position has a reasonable basis. Further, Form 1040X and other amended income tax forms, Form 1045, and the related Instructions to these forms need to be updated to advise taxpayers to state their reasonable basis on the forms in order to avoid a §6676 penalty.*

There is no guidance on how the IRS will determine whether or not a taxpayer's disallowed claim had a reasonable basis. Section 6676 is located in Subchapter B—Assessable Penalties of the Code. Unless otherwise designated, penalties listed in this section are assessable penalties and are not covered by deficiency procedures of §6211.

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29 Treas. Reg. §1.6664-4(b)(1).

30 Treas. Reg. §1.6664-4(b)(1) and -4(c).

For these penalties there is no 30-Day Letter, no agreement forms and no notice required prior to assessment.[31] Accordingly, the IRS can issue a notice imposing a §6676 penalty without providing a taxpayer an opportunity to address the IRS' determination that the taxpayer did not have a reasonable basis for his refund claim or credit.

A claim for refund must identify each ground upon which a refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof, however, this identification may not be sufficient to substantiate the taxpayer's reasonable basis on each ground.[32] While guidance could be issued that requires a taxpayer to identify each ground sufficient to allow the IRS to make a determination of whether the taxpayer has a reasonable basis for his refund claim, *pro se* taxpayers would have difficulty meeting this requirement (e.g., they would have to be aware of what a reasonable basis standard is, how to meet it, and be capable of meeting the standard). Accordingly, the IRS should follow similar procedures used to determine whether to impose an accuracy-related penalty under §6662. That is, the IRS should contact the taxpayer regarding the potential imposition of a §6676 penalty. The taxpayer should be given an opportunity to submit additional information and/or documentation. These procedures may be done in conjunction with the IRS procedures to request to a taxpayer to submit additional information with respect to the underlying refund claim. In addition, the taxpayer should be given the opportunity to meet with the Examiner and the Examiner's supervisor if necessary.

The authors also propose that taxpayer be allowed administrative appeal rights, which are addressed below.

2. Will a §6676 penalty be imposed, and the reasonable basis determination be made, on an issue-by-issue basis?

Proposal: *Guidance should provide that a §6676 penalty is imposed, and the reasonable basis determination is made, on an issue-by-issue basis.*

In general, §6676 provides that if a claim for refund is made for an excessive amount, unless it is shown that the claim for such excessive amount has a reasonable basis, the taxpayer making such a claim shall be liable for a penalty in an amount equal to 20% of the excessive amount. Subsection (b) defines the term "excessive amount" as the amount by which the amount of the claim exceeds the amount of such claim allowed. The only guidance currently issued by the IRS regarding §6676 is a heavily redacted Chief Counsel's Advice ("CCA") addressing how the penalty is computed.[33] It appears from the CCA that the §6676 penalty is computed on the refund claim as a whole.[34]

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31 IRM 20.1.9.1.1 – Common Terms (11-20-2007).

32 Treas. Reg. §301.6402-2(b)(1).

33 CCA 200747020 (Oct. 3, 2007).

34 *Id.* The CCA provides the following "simple" formula to assist in understanding the computation of the penalty:

X = amount of claim for refund or credit requested
Y = amount of claim for refund or credit allowed
X-Y = excessive amount
20%(X-Y) = Amount of the §6676 penalty

Computation of a §6676 penalty on a refund claim as a whole would be unfair to taxpayers. For example, a taxpayer filed a refund claim based on two claims: a business bad debt deduction in the amount of $85,000 and a depreciation deduction in the amount of $35,000. Upon an examination of the refund claim and information submitted by the taxpayer, the IRS allows a bad debt deduction of $5,000 (approximately 6% of the amount claimed) and a depreciation deduction of $15,000 (50% of the amount claimed). On an issue-by-issue basis, the taxpayer would have a reasonable basis in the claim for the depreciation deduction but would not have a reasonable basis in the claim for the bad debt deduction. Thus, the taxpayer would be liable for a §6676 penalty of $17,000 (20% of $80,000). However, if the §6676 penalty is imposed on the total disallowed amount (without regard to the fact that she had a reasonable basis for her claim for the depreciation deduction), the taxpayer would liable for a §6676 penalty in the amount of $20,000 (20% of $100,000). Thus, the taxpayer would be unfairly penalized on the portion of the claim in which she had a reasonable basis.

Vis-à-vis, if §6676 is imposed on a refund claim as a whole, a taxpayer could file a refund claim based on numerous grounds—one with a reasonable basis and many without a reasonable basis—and, if the overall refund claim allowed is sufficient to reach the reasonable basis standard, the §6676 penalty could not be imposed. This would defeat the purpose of the penalty.

3. What does the term "Excessive Amount" include?

Proposal: *Detailed guidance should define what is included in the term "excessive amount." Further, guidance should provide that the §6676 penalty is not applicable to any amount: (i) recovered by the Government as an erroneous refund under §6532(b); (ii) denied due to an untimely refund claim; (iii) denied in an informal claim; or (iv) denied due to the rejection of a "refund claim" because it is not in the proper format.*

Subsection (b) of §6676 defines the term "excessive amount" as the amount by which the amount of the claim for refund or credit for any taxable year exceeds the amount of such claim allowable for such taxable year.

Pursuant to §6532(b), the Government may file a suit to recover an erroneous refund within the two year after making the refund if it appears that any part of the refund

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The CCA further demonstrates the computation of the §6676 penalty by providing the following example:

> [O]n March 8, 2008, taxpayer mails Form 1040, U.S. Individual Income Tax Return, along with a check for $400 to cover the amount due to the applicable IRS Center. On June 10, 2008, taxpayer files Form 1040X, Amended U.S. Individual Income Tax Return, as a result of changes in the amount of itemized deductions. Taxpayer claims a refund (line 23 of Form 1040X) in the amount of $2000. On consideration of the claim, it is determined that the taxpayer is not entitled to a refund in the amount of $2000, rather the amount of the refund allowed is only $1000. The disparity is not due to any argument having a reasonable basis. The excessive amount is $1000 ($2000-$1000). Taxpayer will be assessed a penalty in the amount of $200 (20%($2000-$1000)).

was induced by fraud or misrepresentation of material fact. Section 6676 provides that a penalty will be imposed on the "excessive amount" of a refund claim unless it is shown that the claim for such excessive amount has a reasonable basis. Does the term "claim allowable" mean the amount the IRS allowed on the refund claim or credit? Conversely, would it also include the claim allowable after a suit to recover an erroneous refund?

If a taxpayer files a refund claim outside of the period of limitations prescribed in §6511, the IRS issues a letter stating that it "cannot consider" the refund claim because it was received after the deadline for filing.[35] Is an inability to *consider* a refund claim subject to the §6676 penalty? If the IRS does not consider an untimely refund claim, then a determination of whether that taxpayer had a reasonable basis in the positions for the refund claim cannot be made. Would the IRS make a determination that the taxpayer had no reasonable basis in filing the refund claim because the period of limitations had expired? If so, the entire amount of refund claim would be an "excessive amount" subject to the §6676 penalty. An untimely refund claim should not be the type of behavior subject to the §6676 penalty. Unsophisticated taxpayers may not be aware that there is a period of limitations in which to file a refund claim. Further, as an untimely refund claim is generally picked up and promptly handled at the IRS Center, the IRS is not out a significant sum for its time and effort in issuing a Letter 916.

A taxpayer may file a claim that fails to contain the requisite elements of a "claim for refund" (e.g., a taxpayer makes a claim in a letter or forgets to sign the Form 1040X). In which case, the IRS will reject the claim. As the claim would be insufficient to be deemed a valid "claim for refund" it should also not be subject to the §6676 penalty.

4. Will a §6676 penalty be imposed if the refund claim has reasonable basis but the refund amount is reduced because of an offset?

Proposal: *Guidance should provide that a §6676 penalty does not apply to a refund claim that has a reasonable basis but is reduce or eliminated due to an offset because the penalty only applies if the disallowed refund claim does not have reasonable basis.*

Section 6676 applies only if the disallowed refund claim or any portion thereof does not have reasonable basis. The fact that the refund amount is reduced or eliminated by an offset (e.g., a deficiency arising from a separate tax item or outstanding tax liability from a different tax year)—an item unrelated to the refund claim itself—is irrelevant for purposes of §6676 penalty because the underlying refund claim had reasonable basis.

5. On whom is the §6676 penalty assessed?

Proposal: *Guidance should define who will be assessed the §6676 penalty.*

Section 6676(a) provides that "the person making such claim shall be liable for a penalty." The person making a claim for refund may not be the taxpayer seeking the refund. For example, an executor may make a claim for refund on behalf of a deceased

[35] See, IRS Letter 916 (DO) (Rev. 4-1999).

taxpayer, a trustee may make a claim for refund on behalf of a trust, or a trustee may file a refund claim for a liquidated corporation. The IRS should provide clear guidance on whether it is the individual who signs the refund claim, or the taxpayer for whom a refund claim is made, that will be liable for a §6676 penalty.

6. Will the §6676 penalty apply to an application for tentative refund on Form 1139 or 1045?

Proposal: *Guidance should provide that a §6676 penalty does not apply to an application for a tentative refund on Form 1139 or 1045 because an application for a tentative refund does not constitute a claim for credit or refund.*

Section 6411(d) allows taxpayers to file Form 1139 (or Form 1045 in the case of non-corporate taxpayers) to apply for a quick refund of taxes based on a tentative carryback adjustment from the carryback of net operating losses ("NOL"), net capital loss, or unused general business credit. Generally, an application for a tentative refund must be filed within 12 months of the end of the tax year in which an NOL, net capital loss, unused credit, or claim of right adjustment arose.

Treasury Reg. §1.6411-1(b) states, "[a]n application for a tentative carryback adjustment does not constitute a claim for credit or refund." The procedures for processing an amended return and Form 1139 are different. If the application for a quick refund is denied in whole or part, no suit may be maintained in any court for the recovery of any tax based on such application. Moreover, the filing of an application for a tentative carryback adjustment does not constitute the filing of a claim for credit or refund under §6511 for purposes of determining the timeliness of a claim for credit or refund.[36] Further, the payment of the requested tentative refund does not mean the IRS has accepted the application as correct. If the IRS later determined the claims deductions or credits are due to negligence, disregard of rules, or substantial understatement of income tax or overstatement of value of property, accuracy-related penalties may apply.[37] Accordingly, a §6676 penalty would not apply to an application for a tentative refund filed on Form 1139 or 1045.

7. Will a §6676 penalty apply to a non-refundable claim of credit, such as research and development credit?

Proposal: *Guidance should provide that §6676 penalty does not apply to a nonrefundable credit that offsets taxes on an income tax return.*

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[36] If the IRS disallows the tentative refund claim, the taxpayer may file a standard claim for credit or refund. If that claim is disallowed, the taxpayer may file a suit for refund. Treas. Reg. §1.6411-3(c).

[37] *See* Instructions for Form 1139 (Rev. August 2006), pg. 2. *See also* FSA200119001 (1999) where the FSA held that a claim for tentative refund is not a return for purposes of determining the amount of the accuracy-related penalty, but it is a "rebate" for purposes of determining the underpayment of tax. Thus, "[i]f an underpayment results after consideration of the rebate stemming from the tentative carryback adjustments and any other applicable adjustments, the accuracy-related penalty would apply to any portion of the underpayment attributable to conduct prescribed by §6662, e.g., negligence, substantial understatement, etc."

A credit such as research and development offsets against taxes and is claimed on an income tax return such as Form 1120. If the IRS disallows a portion of such credit, the disallowance would occur during a normal examination procedure. Accordingly, a denial of a credit in this type of circumstance would be addressed in a normal audit procedure, and the accuracy-related penalty provision could apply. Accordingly, §6676 penalty is unnecessary in this type of situation.

8. If a taxpayer adequately discloses his position on his refund claim by attaching a Form 8275, 8275-R or an 8886, will the disclosure protect the taxpayer from a §6676 penalty?

Proposal: *Guidance should provide that a disclosure exception to the §6676 penalty would apply if the taxpayer adequately discloses the tax treatment.*

As it stands now, if it is determined that a taxpayer did not have a reasonable basis, there are no exceptions, including the reasonable cause and good faith exceptions, to a §6676 penalty. However, tax issues sometimes arise in which there is little or no authority (e.g., the issue has never been raised before or it relates to a newly enacted Code provisions), or a taxpayer makes a good faith challenge of an existing IRS position. In these types of situations, it may be difficult (or impossible) to make a determination that the taxpayer's position has a reasonable basis. Taxpayers should not be foreclosed under the threat of penalties from seeking a refund in good faith.[38]

A conservative taxpayer may file her original return without taking into consideration a certain tax issue and pay the related tax. After payment of the tax, the taxpayer would then file a refund claim taking the issue into consideration and include with the refund claim a Form 8275, Form 8275-R or Form 8886 disclosing the tax treatment. Thus, the taxpayer would generally be protected from the imposition of certain penalties, as well as potential examination and collection activities by the IRS. It is in the IRS' best interest to encourage this type of behavior.

A taxpayer may also file a Form 8275, Form 8275-R or a Form 8886 with her original return and subsequently file a refund claim based on the same position disclosed with the original return. On the original return, the taxpayer would be protected from

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[38] In HR 4351, AMT Relief Act of 2007, passed by the House on December 12, 2007, an amendment to §6676 was proposed that provided refund claims based on listed transactions would be deemed to have no reasonable basis. Specifically, this proposed amendment states:

> Section 6676 is amended by redesignating subsection (c) as subsection (d) and inserting after subsection (b) the following new subsection:
>
> > '(c) Noneconomic Substance Transactions Treated as Lacking Reasonable Basis- For purposes of this section, any excessive amount which is attributable to any transaction described in §6662(b)(6) shall not be treated as having a reasonable basis.'"

Such an amendment to §6676 would guarantee a penalty for taxpayers who in good faith wish to challenge the IRS's position on a listed transaction. Taxpayers would either be penalized under §6662A if the listed transaction was reported on their original return or they would be penalized under §6676 for filing a refund claim based on the tax treatment of the listed transaction.

certain penalties because of the disclosure. Would this same protection carryover to the refund claim?

Several Code provision already provide that an adequate disclosure of a tax treatment will protect an individual from a penalty.[39] It is in the IRS' best interest to encourage taxpayers to disclose. Further, the IRS has published these disclosure Forms that, if complied with, are sufficient to protect taxpayers from the imposition of penalties on their original return. These same forms should also be sufficient to protect taxpayers from a §6676 penalty.

9. Will a §6676 penalty be imposed on a "protective refund claim"?

Proposal: *Guidance should provide that refund claims filed to toll the statute of limitations are excepted from a §6676 penalty. Alternatively, that when the contingent event occurs, the taxpayers been given an opportunity to withdraw the protective refund claim prior to the imposition of a §6676 penalty.*

"Protective refund claims"[40] are typically filed to preserve a taxpayer's right to claim a refund when the right is contingent on some future events that may not be determinable until after the statute of limitations expires. Protective refund claims may also be filed based on an expected change in the tax law, other legislation, regulations, or case law.

Typically, the taxpayer requests in the Protective Refund Claim that action on the claim be suspended pending the future event. While the IRS has discretion in deciding how to process protective claims, it typically agrees to delay action.[41] Obviously, at the time a taxpayer files a Protective Refund Claim the taxpayer is unaware of the outcome of the future event. Thus, a determination of whether the taxpayer had reasonable cause at the time the Protective Refund Claim is filed would be difficult. Once the future event has occurred, the determination of whether the claim has reasonable basis can be made.

In light of the fact that Protective Refund Claims are merely filed to toll the statute of limitations and that no action on these types of claims is made until some future event has occurred, which may conclusively resolve or foreclose the claim, such claims should be excepted from a §6676 penalty.

Alternatively, if Protective Refund Claims are not excepted from §6676, once the contingency is resolved, taxpayers should be given the opportunity to withdraw the claim in order to avoid a §6676 penalty.[42] For example, §6702 allows taxpayers a limited time to withdraw a submission the IRS identifies as a "specified frivolous submission" in

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[39] See, e.g., IRC §6662(d); IRC §6694.

[40] "Protective Refund Claim" is a term of art used by practitioners and taxpayers. See *Nucorp, Inc. v. United States*, 23 Cl. Ct. 234, 235, fn3 (1991) (noting that "Nothing can be found in the Code, regulations or case law relative to the efficacy of filing a 'protective claim.'").

[41] IRM 25.6.6 (noting that "In general, it is in the best interests of the Service and taxpayers to delay action on protective claims until the pending litigation or other contingency is resolved.").

[42] *See* §6702(b)(3), which allows taxpayers to avoid §6702 penalty by withdrawing a submission within 30 days after receiving a notice that a submission is a specified frivolous submission.

order for the taxpayer to avoid a frivolous submission penalty.[43] California's Franchise Tax Board also has an informal procedure that allows taxpayer to modify or withdraw a refund claim after a Notice of Disallowance is issued.[44]

10. Can a §6676 penalty be imposed on a refund claim for penalties and interest?

Proposal: *Guidance should provide that §6676 does not apply to denied refund claims for penalties and interest as it specifically states that the penalty is applicable for "a claim for refund or credit with respect to income tax." Further, guidance should clearly provide that §6676 does not apply to any claims for refund or credit on any tax other than income tax.*

Section 6676 provides that if a claim for refund or credit with respect to *income tax* "is made for an excessive amount, unless it is shown that the claim for such excessive amount has a reasonable basis, the person making such claim shall be liable for a penalty in an amount equal to 20 percent of the excessive amount."[45] The courts have consistently interpreted the term "tax" to include penalties, interest and additions to tax. However, §6676 states that it is applicable to refund claims (or credit) of *income tax*. Thus, it appears that §6676 is not applicable to claims for refund with respect to penalties and interest—which would include any refund claim of a §6676 penalty.[46]

For the same reason, §6676 is not applicable to a claim for refund of any tax other than income tax.

11. Is a §6676 penalty applicable to a payment made under the Economic Stimulus Act of 2008?

Proposal: *Guidance should address whether a §6676 penalty is applicable to the recovery rebate credit and the stimulus payment addressed in §6428 as amended under the Economic Stimulus Act of 2008.*

On February 13, 2008, the President signed into law the Economic Stimulus Act of 2008 (the "2008 Act") intended to deliver an expedited fiscal stimulus to the economy.[47] The 2008 Act, amends §6428 to provide for "recovery rebates" to eligible individuals with qualifying income.[48] In 2008, eligible individuals will receive a refundable tax credit of up to $600 ($1,200 for joint filers) and a child credit of $300 per qualifying child (collectively the "recovery rebate credit"). The recovery rebate credit will be payable in the form of advance rebate checks (the "stimulus payment") based on a

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43 *Id.*

44 But see, Treas. Reg. §301.6402-2(b) providing that a timely refund claim may not be amended to include other and different grounds after the statutory period of limitation applicable to the filing of a claim has expired.

45 IRC §6676(a) (emphasis added).

46 If §6676 penalty does apply in this circumstance, the standard should be whether the subject penalty and interest has reasonable basis.

47 HR 5140, Economic Stimulus Act of 2008, P.L. 110-185 (Feb. 11, 2008), 110th Congress.

48 *Id.* at Sec. 101.

taxpayer's 2007 tax return.[49] In Notice 2008-28, the IRS stated that for eligible individuals who are not required by §6012(a) or §6017 to file an income tax return, but who have qualifying income in 2007, the IRS "will treat a Form 1040A prepared . . . [as prescribed] as a valid claim for refund in the amount of the 2008 economic stimulus payment."[50]

Section 6428(g)(1) treats an eligible individual as having made a payment in 2007 against the income tax for that year in an amount equal to the amount of the stimulus payment.[51] As a result, the stimulus payment is treated as an overpayment of tax for 2007 that the IRS is directed to rapidly refund or credit to eligible individuals.[52] Thus, §6428 technically treats the stimulus payment as a deemed overpayment of tax in 2007 and provides a refund procedure.

For taxpayers required to file a 2007 return, their 2007 returns are not claims for refund with respect to the recovery rebate credit, nor are these taxpayers seeking the recovery rebate credit on their 2007 returns (i.e., the taxpayers have not made an affirmative claim). Under §6428, the IRS is *treating* the taxpayers as having made a claim for refund and using the information provided on the taxpayers' 2007 returns to determine the amount. Although §6428 *technically* treats the stimulus payment as a deemed overpayment of tax in 2007, it is not an actual refund claim because there was no real overpayment of tax in 2007 for individuals receiving the stimulus payments. Accordingly, §6676 should not be applicable to these taxpayers' 2007 returns.

For taxpayers who file 2007 Form 1040A merely to qualify for the recovery rebate credit and receive a stimulus payment, it is arguable that they have made an affirmative claim. The IRS has stated it will treat these Forms 1040A as *valid* claims for refund.[53] If the IRS treats these claims as "valid" claims for refund, and the Form 1040A is reasonably accurate, then these claims would have "reasonable basis" and a §6676 penalty would not be applicable. Further, again these taxpayers are not *actually* filing claims for refund nor was there a real overpayment of tax in 2007 for these individuals. If a taxpayer files a Form 1040A with false information in order to obtain a stimulus payment, then the accuracy-related or fraud penalties could be applicable, in addition to potential criminal sanction for filing false claims.

Section 6428(f) addresses the coordination of the recovery rebate credit with the stimulus payment. This section provides that the amount of the recovery rebate credit shall be reduced (but below zero) by the amount of the refund and credit paid to the taxpayer during 2008.[54] Thus, for their 2008 returns, taxpayers will need to reconcile the amount of the recovery rebate credit with the stimulus payment they received by

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[49] Joint Committee on Taxation, Technical Explanation of the Economic Stimulus Act of 2008 (JCX-16-08).

[50] *See* Notice 2008-28, I.R.B. 2008-10 (Feb. 22, 2008) (setting forth procedures for individuals not otherwise required to file returns to file Forms 1040A in order for the IRS to determine and issue the stimulus payment). Section 6402 and Treas. Reg. §301.6402-3 authorize taxpayers to seek a refund or credit of overpaid income tax by filing a properly executed individual income tax return.

[51] IRC §6428(g)(1).

[52] IRC §6428(g)(3).

[53] *See* Notice 2008-28, I.R.B. 2008-10 (Feb. 22, 2008).

[54] IRC §6428(f)(1).

completing the worksheet calculating the amount of the recovery rebate credit based on their 2008 income tax return. They will then subtract from the recovery rebate credit the amount of the stimulus payment they received in 2008. For many taxpayers, these two amounts will be the same. If, however, the result is a positive number (e.g., the taxpayer paid no tax in 2007 but is paying tax in 2008), the taxpayer may claim that amount as a refundable credit against their 2008 tax liability. Conversely, if the result is negative (e.g., the taxpayer paid tax in 2007 but owes no tax for 2008), the taxpayer is not required to repay excess amount received.[55]

It appears that a §6676 penalty would be applicable to the recovery rebate credit with respect to a taxpayer's 2008 return. The recovery rebate credit is a refundable credit[56] that is being sought on a taxpayer's 2008 return and §6676 is applicable to credits made for an excessive amount. However, the real issue may lie as to whether the IRS will deny a taxpayer such a credit. The credit has already been made through the stimulus payment in 2008 and it is the taxpayer's 2007 return that triggered the advanced payment of the credit. The IRS has stated that the stimulus payments have no effect on tax returns filed for 2008; the amount is not includible in gross income and it does not otherwise reduce the amount of withholding.[57] Further, if in reconciling the amount of the recovery rebate credit with the stimulus payment, the taxpayer is not required to repay the excess amount received, will the IRS be reviewing these claims for credit and making a determination to disallow the credit?

12. What is the administrative appeal process if a §6676 penalty is assessed?

Proposal: *Guidance should provide that if a §6676 penalty is assessed, the IRS must explain the specific reason(s) as to why the claim did not meet the reasonable basis standard. Further, guidance should be issued and the IRM should be amended to provide that taxpayers have the right to appeal a §6676 penalty prior to assessment.*

Presumably, the IRS will review whether a §6676 penalty is appropriate at the same time it reviews the underlying refund claim. When a refund claim is filed, the IRS can deny, accept, or examine the claim. If a claim is examined, the procedures are almost the same as in the examination of a tax return, including the right to an administrative appeal. If the IRS denies a refund claim, an Examiner will send a Letter 569 explaining the specific reasons why the claim for refund is disallowed or partially disallowed.[58] If the taxpayer does not agree with the Examiner's findings as explained in the Letter 569, the taxpayer may request a meeting or conference call with the Examiner's supervisor.[59]

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[55] Joint Committee on Taxation, Technical Explanation of the Economic Stimulus Act of 2008 (JCX-16-08).

[56] IRC §6428(c).

[57] Joint Committee on Taxation, Technical Explanation of the Economic Stimulus Act of 2008 (JCX-16-08).

[58] IRS Publication 556 (8/2005).

[59] See, Letter 569 (DO) (Rev. 9-2000).

If the taxpayer still does not agree with the determination, the taxpayer may request a conference with an Appeals Office.[60]

Section 6676 is located in Subchapter B—Assessable Penalties of the Code. Unless otherwise designated, penalties listed in the Assessable Penalties section are assessable penalties and are not covered by deficiency procedures of §6211. For these penalties there is no 30-Day Letter, no agreement forms and no notice required prior to assessment.[61]

Appeals has the right to review all penalties provided under Chapter 68, which includes the §6676 penalty.[62] Certain chapter 68 penalties that have been assessed may be appealed before payment is made (i.e., post-assessment review). A §6676 penalty may be considered a penalty eligible for post-assessment review as it allows a reasonable basis defense.[63]

It is more efficient and cost effective to give taxpayers the right to appeal a §6676 penalty prior to assessment (i.e., pre-assessment appeal review). Including the §6676 penalty in the Appeals' pre-assessment review procedure makes sense since the §6676 penalty is likely to be asserted, if at all, at the end of the refund claim examination and as part of the proposed disallowance of claim that can be protested prior to a final determination. It does not make sense to bifurcate the refund claim protest process from the penalty review process. Further, it is more efficient and cost effective for the IRS, after pre-assessment review of a §6676 penalty, to include in a taxpayer's Letter 569 the specific reason(s) as to why a position taken on a refund claim does not meet the reasonable basis standard.

The authors also propose that taxpayers who are unable to administratively resolve the penalty issue can seek judicial review, which is addressed below.

13. If a §6676 penalty is imposed on a joint refund claim, may a spouse seek relief from the penalty under the Innocent Spouse provisions of §6015?

Proposal: *Guidance should provide that if a §6676 penalty is assessed, the Innocent Spouse provisions under §6015(f) are available.*

The purpose of §6015 is to allow an innocent spouse, who merely signed a joint return, relief from liability for errors on the return attributable to the actions of the other spouse. Section 6015 provides three forms of relief from joint and several liabilities on joint returns: (1) traditional innocent spouse relief; (2) relief on an apportioned basis; and

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60 *Id.*

61 IRM 20.1.9.1.1 – Common Terms (11-20-2007).

62 See Treas. Reg. §601.106(a)(1)(ii), which grants Appeals subject matter jurisdiction to consider all penalties that are assessable under Chapter 68. See also Delegation Order 66 (Jan. 23, 1992).

63 See Treas. Reg. §601.106.

(3) equitable relief.[64] Currently, of these forms of relief only equitable relief under §6015(f) can be used to seek relief from a §6676 penalty.[65]

Section 6015(f) provides that the IRS has discretion to provide relief if, taking into account all the facts and circumstances, it is inequitable to hold an individual liable for any unpaid *tax* or any deficiency and relief is not available to such individual under §6015(b) or (c). Section 6671 provides that "[e]xcept as otherwise provided, any reference in this title to 'tax' imposed by this title shall be deemed also to refer to the penalties and liabilities provided by this subchapter.[66] In *Aranda v. Commissioner*, the Court of Appeals for the Tenth Circuit held that granting relief only as to a fraud penalty and interest was permissible under §6015(f).[67] "One could certainly find it inequitable to impose a fraud penalty on an innocent taxpayer when the penalty arises out of fraud by the taxpayer's former spouse."[68]

The facts and circumstances where a spouse signed a joint refund claim but should not be liable for a §6676 penalty may include: (i) a spouse signed the joint refund claim did not know, or have reason to know, that the position taken on the claim did not have a reasonable basis; (ii) a spouse signing a joint refund claim under duress; (iii) a spouse in poor mental or physical health signed the joint refund claim; and (iv) the individuals were separated or divorced at the time the refund claim was signed.

If a taxpayer requests relief under §6015(f) from a §6676 penalty and the IRS denies the request, the taxpayer can petition the Tax Court. However, §6015(e)(3) provides that if a suit for refund is begun by either individual filing the joint return pursuant to §6532, the Tax Court shall lose jurisdiction of the innocent spouse's action to whatever extent jurisdiction is acquired by the district court or the Claims Court over the taxable years that are the subject of the suit for refund and the court acquiring jurisdiction shall have jurisdiction over the petition filed under §6015(f).

D. Procedures for Determining When a §6676 Penalty Will be Imposed.

Proposal: *Guidance should provide that, barring any statute of limitations issues, a §6676 penalty must be proposed at the time the IRS issues a notice of claim disallowance. Further, guidance should provide that if a taxpayer has filed a suit for refund the Government is barred from imposing a §6676 penalty.*

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64 See IRC §6015(b), (c), and (f).

65 Innocent spouse relief under §§6015(b) and 6015(c) is not applicable to a §6676 penalty because these subsections require a deficiency as a condition of relief. See *Billings v. Comm'r*, 127 TC 7 (2006). A "deficiency" is generally defined as the excess of the tax (income, estate, gift, or excise) over the sum of the amount shown as such tax by the taxpayer upon his return and the amounts previously assessed (or collected without assessment) as a deficiency. Any amount shown as additional tax on an "amended return" filed after the due date of the return, shall be treated as an amount shown by the taxpayer "upon his return" for purposes of computing the amount of a deficiency. Treas. Reg. §301.6211-1.

66 See, also, IRC §6665(a)(2) (fraud penalties are treated as taxes).

67 *Aranda v. Comm'r*, 432 F.3d 1140 (10th Cir. 2005). *Cf. Cheshire v. Com*m'r, 115 T.C. 183, 197-99 (2000) (spouse not entitled to relief under §6015(b) or (c) was nonetheless entitled to relief under §6015(f) from substantial-underpayment penalty), *aff'd on other grounds*, 282 F.3d 326 (5th Cir. 2002).

68 *Aranda v. Comm'r*, 432 F.3d 1140, 1144 (10th Cir. 2005).

It is not clear when the IRS will assess a §6676 penalty. Section 6671 provides that penalties provided under Subchapter B shall be assessed and collected in the same manner as taxes.[69] Accordingly, the IRS can impose a §6676 penalty at anytime within the period of limitations in which the underlying tax may be assessed and collected. Assessment of tax is generally subject to a three-year period to the extent they pertain to a particular tax return under §6501(a). A §6676 penalty, however, is not imposed on any tax, but on the disallowed amount of the refund claim.

If the statute of limitations period under §6671 applies, then a §6676 penalty could only be imposed prior to the expiration of the statute of limitations for assessment on the original return. Assuming that most refund claims are filed shortly before the statute of limitations on assessment expires, the statute of limitations to impose the penalty will most likely have expired by the time the IRS acts on a refund claim—rendering §6676 toothless. If the statute of limitations for assessment on the original return has not expired, but will do so shortly, will the IRS impose a §6676 penalty before fully developing the facts regarding whether the taxpayer had a reasonable basis?

If the statute of limitations period under §6671 does not apply, what is the applicable limitations period? The IRM provides that penalties not considered taxes generally have no statute of limitation for assessment.[70] There are also several Code provisions that provide limitation periods relating to refund claims. For example, §§6532(b) and 7405 provide that the Government has a two-year period of limitation to file a suit to recover an erroneous refund. This time period is measured from the date the IRS issued the refund. Section 6696 provides for a three-year period of limitations measured from the date the refund claim was *filed* for penalties imposed under §§6694 and 6695. If the period of limitations to assess a §6676 penalty were measured from the date the refund claim if filed, would the Timely-Mailed Timely-Filed rule under §7502 be applicable? Lastly, the mitigation provisions of §§1311 through 1314 also may apply to permit a refund that would otherwise be barred by the statute of limitations.

If the IRS does not respond within six months of taxpayer's filing of a refund claim and the taxpayer files a suit for refund suit, will the Government raise a §6676 penalty as an offset in the refund suit? The IRS should be precluded from imposing a §6676 penalty after a taxpayer has filed a suit for refund because such imposition would impede the efficient adjudication of the refund suit. The issue of timing of the imposition of a §6676 penalty and the related jurisdictional issues are discussed below.

E. Judicial Review of a §6676 Penalty.

What are the judicial remedies available to the taxpayer if she disagrees with the IRS' determination that she did not have a "reasonable basis" for her refund claim? Currently, the statute leaves the issue of judicial review unclear.

Prior to addressing which court has jurisdiction to review the imposition of a §6676 penalty, the issues of the timing of the imposition of the penalty, and whether full

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69 IRC §6671(a).

70 IRM 20.1.9.1.1 – Common Terms (11-20-2007).

payment is required prior to seeking a judicial remedy, must first be addressed as these issues affect the issue of jurisdiction.

1. Timing issues regarding when a §6676 penalty is raised.

Ignoring for the moment statute of limitation issues, there are generally three time periods in which a §6676 penalty could be raised that affect the issue of jurisdiction: i) prior to the taxpayer filing a suit for refund; ii) after the taxpayer has filed a suit for refund but before a determination in the suit has been made; and iii) after a decision in a suit for refund has been made. Each of these time periods gives rise to judicial jurisdiction issues.

2. Payment of a §6676 penalty.

Proposal: *For efficient adjudication, the same court should review the refund claim and any related §6676 penalty. However, a taxpayer should not be required to pay a §6676 penalty as a prerequisite to adjudicating it. Further, the IRS should amend the Instructions to Form 1040X and other amended income tax return forms to inform taxpayers that they must state the potential for a §6676 penalty on a refund claim to preserve the right to adjudicate the issue, but that payment of the penalty is not required to bring a suit for review of the penalty.*

The issue of requiring full payment of a §6676 penalty complicates the jurisdictional purview of the district courts or the Claims Court. Section 7422(a) provides that "No suit or proceeding shall be maintained in any court for the recovery of an internal revenue tax alleged to have been erroneously or illegally assessed or collected . . . until a claim for refund or credit has been duly filed with the Secretary." The Supreme Court in *Flora v. United States*, ruled that a taxpayer must make *full* payment of an assessment before the taxpayer can maintain a refund suit.[71] The Court based this construction in large part on its concern that a taxpayer not be permitted to split a cause of action for a single taxable year between a refund forum and the Tax Court.[72] Partial payment will not suffice. In other words, a petitioner must "pay the tax and then sue."[73]

In *Shore v. United States*, the Court of Appeals for the Federal Circuit held that the full payment rule of *Flora* does not require a taxpayer to pay penalties before filing a claim for refund, *unless* the taxpayer asserts a claim over assessed penalties on grounds not fully determined by the refund claim for recovery of tax.[74] In which case, the taxpayer would be required to prepay such penalties as well as the assessed tax. The policy of the Tax Division of the Justice Department is that if the taxpayer directly contests the penalty, the Department will challenge jurisdiction unless the penalty is fully

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71 *Flora v. United States*, 362 U.S. 145, 150-51 (1960) (emphasis added).

72 *Id.* at 164 ("The result is a system in which there is one tribunal for prepayment litigation and another for post-payment litigation, with no room contemplated for a hybrid of the type proposed by petitioner."). See also, IRC §7422(e).

73 *Flora*, 362 U.S. at 164.

74 *Shore v. United States*, 9 F.3d 1524 (Fed. Cir. 1993). The Ninth Circuit seems to follow this position as well. See *Moe v. United States*, 1997 U.S. Dist. LEXIS 10272 (D. Wash. 1997) (noting the persuasiveness of the decision in *Shore*).

paid. Conversely, if the penalty is merely an uncontested additional amount dependent on the amount of the tax liability in question, the Justice Department will not raise the lack of full payment of the penalty as a jurisdictional defense.[75] By contrast, the IRS' position is that all penalties must be paid in all circumstances for a suit for refund of those taxes and penalties for jurisdiction to be proper.[76]

Thus, it appears that under current law, a taxpayer seeking to challenge the imposition of a §6676 penalty would have to fully pay the penalty prior to seeking judicial review in the district court of Claims Court.[77] If the taxpayer does not pay the penalty and the IRS proceeds with collection activity, the taxpayer can avail himself of the CDP hearing provisions of §6330.[78] Further, under §6330(d), the taxpayer could seek judicial review by the Tax Court.

For efficient adjudication, the same court should review a refund claim and the related §6676 penalty. Further, a taxpayer should not be required to pay the §6676 penalty as a prerequisite to adjudicating the penalty. Making the payment (including any collection issues) and subsequently filing a refund claim for payment of the penalty would either unduly delay litigation of the underlying refund claim or unnecessarily duplicate adjudication of the same issue (i.e., the taxpayer's position in the refund claim and whether the position had a reasonable basis). Further, under currently law, a §6676 could be significant.

3. Jurisdictional concerns raised by a §6676 penalty.

Proposal: *Section 6676 should be amended to grant jurisdiction to the district courts or the Claims Court to review a §6676 penalty in a refund suit, even if the penalty was not raised in the refund claim or has not been paid to allow efficient adjudication of the refund claim, including the collateral penalty under §6676. Further, pending any statutory amendment, the IRS should provide guidance on how taxpayers can preserve*

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[75] *Payne v. United States*, 1988 U.S. Dist. LEXIS 16871 (D. Vt. 1988).

[76] See, TLB 3080 (TLB 1990) ("The IRS construes the term 'assessment' to include penalties associated with the tax. Thus, in order to maintain a suit for refund of taxes, any penalty associated with the tax must also be paid in full. To allow the taxpayer to pay only the tax, and not the penalty, would potentially bifurcate the litigation, thereby permitting the possible scenario where the tax could be litigated as a refund action and the penalty associated with the tax could be litigated in Tax Court. Such a splitting of forums was precisely what *Flora* sought to discourage.") (citation omitted).

[77] After payment of a §6676 penalty, would a taxpayer have to first file a refund claim with the IRS before filing a suit for refund?

[78] In *Callahan v. Comm'r*, 130 T.C. No. 3 (2/3/2008), the Tax Court held that it has jurisdiction under the CDP hearing provision of §6330(d)(1) to review a case when the underlying tax liability is frivolous return penalties. There, the IRS assessed two $500 penalties against taxpayers for filing a frivolous income tax return for 2003. The IRS sent a final notice of intent to levy, and taxpayer timely submitted to the IRS request for a CDP hearing to challenge §6702 frivolous penalties. The Tax Court reasoned that §6330(d)(1) was amended in 2006 to expand its review of the IRS's collection activity regardless of the type of underlying tax involved so that all appeals of CDP determinations are to be made to the Tax Court. A taxpayer may raise at a CDP hearing any amounts of underlying tax liability for any tax period if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability. The Tax Court stated that the phrase "underlying tax liability" includes any amount a taxpayer owes pursuant to the tax laws that are subject to the Commissioner's collection activities, including the frivolous return penalties.

their right to litigate §6676 penalties in district court or the Claims Court by raising the potential penalty in all refund claims.

a. *Tax Court jurisdiction.* If a §6676 penalty is imposed before the taxpayer has filed a suit for refund, after exhausting administrative appeal remedies, can the taxpayer seek judicial review by filing a petition to the Tax Court?

Under current law, a §6676 penalty is an assessable penalty that is not covered by deficiency procedures of §6211. Thus, a §6676 penalty can be immediately assessed without the usual deficiency procedures that would otherwise permit petitioning to the Tax Court before assessment. If a §6676 penalty were imposed through the deficiency procedures, then the Tax Court would have jurisdiction to hear the matter, and thus also have jurisdiction to hear the underlying refund claim. The Tax Court may also have jurisdiction to review the imposition of a §6676 penalty through judicial review of a CDP matter.[79]

b. *District court or Claims Court jurisdiction.* If a §6676 penalty is imposed after the taxpayer has filed a suit for refund, does the district court or Claims Court have jurisdiction to review the imposition of the penalty?

If the IRS does not issue a notice of claim disallowance within six months of the filing of a refund claim, a taxpayer may bring a suit for refund in a district court or the Claims Court. However, jurisdiction for these courts only allows a taxpayer to bring a suit to recover a refund of taxes *on the grounds that have been raised in the claim for refund*.[80] Subject matter jurisdiction is conferred concurrently on the district courts and the Claims Court to hear "any civil action or claims against the United States for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been *collected* without authority."[81] As a §6676 penalty is imposed *after* a taxpayer files a claim for refund, a request for relief from the penalty would not have been raised in the refund claim. An educated taxpayer or a taxpayer who could afford a tax professional, would be most likely include in his refund claim a potential §6676 penalty as a protective basis to obtain judicial review. However, a *pro se* taxpayer would not know to include a provision regarding a potential §6676 penalty (in fact, a *pro se* taxpayer would most likely be unaware of the penalty).

If the taxpayer seeks judicial review from the Tax Court of a §6676 penalty through the CDP hearing provisions of §6330, under §7422(e) the district court or Claims Court (as the case may be) shall lose jurisdiction of the taxpayer's suit for refund to whatever extent jurisdiction is acquired by the Tax Court. Arguably, as the basis for the imposition of the §6676 penalty is the underlying basis of the refund claim, the Tax Court could acquire jurisdiction of the penalty issue as well as the refund claim. If the Tax Court does not acquire jurisdiction of the refund claim, a taxpayer would end up with a suit for refund in the district court or Court of Claims on the underlying refund claim and

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[79] See *Id.* (court held that it had jurisdiction under the §6330(d)(1) CDP hearing provisions to review a case when the underlying tax liability is frivolous return penalties).

[80] *Boyles v. United States*, 2000-1 USTC ¶50243; *Parma v. United States*, 45 Fed. Cl. 124 (1999).

[81] IRC §1346(a)(1) (emphasis added).

a case in Tax Court regarding the §6676 penalty. This is precisely the type a situation the Supreme Court in *Flora* sought to avoid.[82]

Conflicting jurisdiction issue also can be triggered by the taxpayers need to file a suit for refund because of statute of limitation issue in the district court or Claims Court during the time the Tax Court is considering the issue of the §6676 penalty. If the IRS issues a Notice of Disallowance, the taxpayer has two years to file a suit for refund.[83] Conversely, assume a taxpayer pays a §6676 penalty. What would be the statute of limitations to seek a refund of this payment? If the statute would be similar to the two year from date of payment statute under §6511, a taxpayer may have to file a claim for refund on the payment of the §6676 penalty while the suit for refund on the underlying refund claim is pending. If the IRS disallows the taxpayer's claim for refund on the penalty, the taxpayer made have to file a suit for refund of the §6676 penalty payment. While this may not cause conflicting jurisdiction, it may result in a taxpayer having two refund suits before the district court or Claims Court.

Lastly, after the conclusion of a suit for refund in which a court denies a taxpayer's claim, can the IRS impose a §6676 penalty (ignoring any statute of limitations issues)? While a holding in a refund suit will determine whether, and to what extent, a refund claim is granted, such a holding would not specifically address the issue of whether the taxpayer had a reasonable basis. Such a determination could only be made if the §6676 penalty was at issue in the case. That is, a taxpayer could still challenge the imposition of a §6676 penalty after resolution of the underlying refund claim. It is an inefficient use of all of the parties' (i.e., the taxpayer, the Government and the court) time if the IRS waits to impose a §6676 penalty until after resolution of the refund claim.

IV. SUPPORT FOR LIMITING THE SECTION 6676 PENALTY TO $5,000 WITH A MECHANISM THAT WOULD ALLOW REDUCTION OF THE PENALTY

Currently, §6676 could impose a penalty much higher than the maximum penalty imposed for filing a *frivolous* return or suit. For example, if a taxpayer filed a refund claim seeking a $150,000 refund and the IRS denies this claim and determines that the taxpayer's did not have a reasonable basis for his position, the taxpayer will be liable for a $30,000 penalty under §6676. However, if this same taxpayer took a *frivolous* position—a standard far below "reasonable basis"—on a submission to the IRS, under §6702[84], he would be liable for a $5,000 penalty. A "frivolous" position is a position that on its face has no basis for validity in existing law.

There are several Code provisions that impose civil penalties for taxpayers who file frivolous returns or claims. Under these provisions, the highest civil penalty that can be imposed on a taxpayer is $25,000. For example, as noted above, §6702 allows the

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[82] *Flora*, 362 U.S. at 164 (Court based this construction in large part on its concern that a taxpayer not be permitted to split a cause of action for a single taxable year between a refund forum and the Tax Court).

[83] IRC §6532(a).

[84] Under the Tax Relief Health Care Act of 2006, §6706 was amended to increase the penalty from $500 to $5,000, as well as to make the penalty applicable to "specified frivolous submissions."

imposition of a $5,000 penalty for frivolous income tax returns and for specified frivolous submissions other than returns.[85] Section 6673(a) provides that whenever it appears to the Tax Court that a taxpayer's position in a proceeding is *frivolous or groundless*, the Tax Court may impose a penalty not to exceed $25,000. Further, §6673(b)(2) provides that, whenever it appears to a reviewing court, other than the Tax Court, that a taxpayer's position in a proceeding is *frivolous or groundless*, the court may impose a penalty not in excess of $10,000. The Seventh Circuit addressed the purpose in imposing a penalty for initiating a frivolous or groundless proceeding:

> The purpose of §6673 . . . is to induce litigants to conform their behavior to the governing rules regardless of their subjective beliefs. Groundless litigation diverts the time and energies of judges from more serious claims; it imposes needless costs on other litigants. Once the legal system has resolved a claim, judges and lawyers must move on to other things. They cannot endlessly rehear stale arguments . . ..[86]

Congress determined that the maximum penalty for diverting the "time and energies" of the IRS and the courts on a frivolous position is $25,000. Yet, §6676 could impose a much greater penalty for taxpayer whose claim had less than a 20% chance of succeeding on the merits. Imposing a greater penalty on a taxpayer whose position has at least some merit than on a taxpayer whose position on its face has no basis for validity in existing law is unjust. Accordingly, §6676 should be amended to limit the maximum penalty amount. Moreover, the maximum penalty amount for a §6676 penalty should be less than the penalty amount imposed for bringing frivolous cases before the court (i.e., $10,000 and $25,000), which diverts the time and energies of the Government *and* the courts. Thus, the authors propose that §6676 should be amended to impose a penalty not in excess of $5,000, which is the same maximum penalty imposed for filing a frivolous tax return or for a specified frivolous submission to the IRS, as well as the same procedural protections given to taxpayers under §6702 (i.e., the right to withdraw a refund claim after notice, a mechanism that would allow the IRS to reduce the penalty and an advance public notification of the positions the IRS deems to have less than reasonable basis).

V. CONCLUSION

The authors have raised numerous issues relating to §6676 that will overly burden the Government and the courts without producing any offsetting benefits. Thus, the authors propose:

1. Repeal §6676 because enforcement will unduly burden the Government and the courts and it unfairly burdens taxpayers by imposing a penalty that is disproportionate to the "injury" received.

2. Alternatively, provide clear guidance and the use of practical examples to assist the taxpayers, practitioners and the Government in determining: (i) the standard of

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85 IRC §6702(b)(2)(B).

86 *Coleman v. Comm'r*, 791 F.2d 68, 72 (7th Cir. 1986).

"reasonable basis"; (ii) procedures for the imposition of the penalty; (iii) procedures for administrative and judicial review of the penalty; and (iv) the statute of limitations for imposing a penalty under §6676.

3. Alternatively, in conjunction with the bright-line guidance, it is recommended that a ceiling be placed on the amount of penalty that can be imposed under §6676, coupled with the procedural safeguards that apply to the imposition of any tax deficiency.

The Government should carefully consider the issues and concerns set forth in this paper and either repeal or amend §6676.