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SPRING 2021

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Penalties Invalid if IRS Does Not Get Proper Approvals

by Michael P. Duffy, Esq. | 508-459-8043 | mduffy@fletchertilton.com

When the IRS discovers that a taxpayer failed to report income on their tax returns, or adjusts the amount of tax they owe in an audit, there is a chance that something known as the Section 6662 accuracy-related penalty will be assessed. The penalty, which is equal to 20% of the amount of additional tax the taxpayer failed to report and pay on their originally filed return, can make large audit adjustments even more painful.

What is less commonly known is that prior to imposing a Section 6662 penalty, in many cases IRS field agents need to obtain written approval from an immediate supervisor. As has recently been discovered in a series of court cases, however, the IRS has not always followed the law in getting the requisite approvals before the penalty communications are sent to taxpayers. The IRS errors create potential refund opportunities for certain taxpayers.

BASIS FOR SECTION 6662 PENALTY

The Section 6662 penalty may be imposed when there is an underpayment of tax and the IRS determines some or all of the underpayment was due to negligence or a disregard of the tax rules and regulations. The Section 6662 penalty may alternatively be asserted when there is an understatement of tax that exceeds 10% of the amount of tax required to be shown on the taxpayer's return for a given year, provided this 10% amount exceeds $5,000. IRS agents can use one or both arguments as a basis to impose a Section 6662 penalty on a taxpayer.

Taxpayers are eligible to have Section 6662 penalties reversed if they can show there was "reasonable cause" for the underpayment. Essentially, to qualify for the abatement, the taxpayer needs to show they reasonably relied on incorrect professional advice or incorrect information in computing their tax liability. Although this rule is conceptually fair, it can be practically very difficult for taxpayers to convince the IRS that the they acted in good faith in making the mistake if a professional was not involved in preparing the tax returns or if there is little contemporaneous documentation concerning the taxpayer's decision-making process when the return was prepared. The IRS also applies heightened scrutiny to determining whether there is reasonable cause in situations where the underpayment of tax is large.

The IRS errors create potential refund opportunities for certain taxpayers.

SUPERVISORY APPROVALS ARE REQUIRED

Congress became concerned in the late 1990s that the threat of imposing a Section 6662 penalty could be used by the IRS to exert unfair leverage over taxpayers. The primary concern was that agents could tell taxpayers the IRS would impose a penalty unless they conceded to particular audit issues. Congress found this practice to be abusive and passed Section 6751 to combat the problem.

Section 6751 requires a lower-level employee to obtain the approval of an immediate supervisor prior to making an "initial determination of [a penalty assessment]." Section 6751 applies whenever or not the IRS proposes a Section 6662 adjustment that is not based on an uncontested automated-underreporter adjustment.

Although Section 6751 was added to the Internal Revenue Code in 1998, it did not receive a lot of attention among tax practitioners until the past five years or so. At issue has been when exactly field agents need to obtain approval to assess a Section 6662 penalty.

Technically, a penalty is not legally "assessed" until it is due and owing. If the penalty requires supervisory approval at any point prior to final assessment, then the IRS could conceivably assert a penalty against a taxpayer and obtain the supervisory approval at any point before a final decision is reached in a subsequent court proceeding. Subsequent developments have revealed that supervisory approval at such a late stage in an audit or judicial case does not comport with the intent of Congress when Section 6751 was initially passed.

Recent cases have confirmed that the Section 6751 supervisory approval is an element to the imposition of a Section 6662 penalty. As such, if the IRS does not properly obtain authorization to threaten the imposition of this penalty prior to sending certain communications to the taxpayer, the penalty is invalid. Many recent cases have explored exactly when supervisory approval is required in a myriad of different situations. The cases have also revealed failures at the IRS to obtain appropriate approvals and created significant taxpayer victories.

IRS MISTAKES CREATE REFUND OPPORTUNITIES

The recent Section 6751 cases present refund opportunities for some taxpayers. Although IRS field agents may not have been intentionally circumventing the supervisory approval process by including Section 6662 penalties in certain communications, this does not change the fact that many accuracy-related penalties may not have been properly assessed and are therefore invalid. Taxpayers who have been hit with significant audit adjustments and Section 6662 penalties in the past several years should review their administrative files and confirm that the proper procedures were followed.

We have also identified opportunities where Section 6662 penalties have been assessed pursuant to contested automated-underreporter reviews. An automated-underreporter review occurs when the IRS receives a W-2 or 1099 from a third party that does not appear

to be on the taxpayer's return. Rather than conducting a full audit, the IRS simply sends a notice proposing to add the missing item to the taxpayer's income and computes the additional tax due. If the discrepancy is large enough, an automatic Section 6662 will be added. Because the Section 6662 penalty in these cases is being automatically computed by "electronic means," the IRS does not need to obtain Section 6751 approval. If the taxpayer contests the automated-underreporter notice, however, the IRS must then actually look at the file and obtain a Section 6751 approval to impose any sort of accuracy-related penalty.

...and recent court cases have confirmed that not all penalties asserted are necessarily valid.

Due to COVID-19-related disruptions, the IRS is frequently not timely processing taxpayer responses to automatic-underreporter notices. Instead, the IRS is ignoring taxpayers and issuing Notices of Deficiency as if no response was submitted. When this occurs, per se the government should lose its ability to impose a Section 6662 penalty because the deadline for supervisory approval has passed by the time the Notice of Deficiency has been issued.

If you have recently been threatened with or paid a large Section 6662 penalty, please reach out to us. Taxpayers are under no obligation to pay more tax to the government than is required under the law, and recent court cases have confirmed that not all penalties asserted are necessarily valid. FT

The Rock or The Hard Place?: Dealing with Federal and State Tax Debt

by Michael P. Duffy, Esq. | 508-459-8043 | mduffy@fletchertilton.com

Taxpayers with both federal and state tax liabilities often find themselves between a rock and a hard place. After all, both the Internal Revenue Service (IRS) and the Massachusetts Department of Revenue (DOR) have extensive collection powers and can impose harmful interest and penalties on delinquent taxpayers.

In general, when a taxpayer does not have the funds to pay both jurisdictions, there is no automatic "right" approach to dealing with back taxes. Instead, multiple considerations need to be taken into account in determining the best path forward. This article is a short summary of issues to consider in resolving liabilities to more than one revenue authority.

COLLECTION POWERS

As a matter of course, once the total debt owed exceeds $10,000, the IRS will normally record a lien against a taxpayer personally at the location of their primary residence to put creditors on notice. If the taxpayer has other interests in real property, these will also be hit with a lien. The lien has an adverse effect on the taxpayer's credit score and frequently disrupts their ability to access any equity in the property. The IRS typically does not move to foreclose on liens, but the filing gives the IRS significant leverage to get the taxpayer to come forward with some sort of workout proposal.

The IRS in some cases will pursue remedies such as garnishments and levies, as well as offsetting any refunds the taxpayer will potentially receive for later periods. Garnishment of wages can be embarrassing for employees with tax problems, as it requires the employer to withhold funds and remit them to the government directly. A levy is probably the most invasive action the IRS can take. A levy is a written order the IRS can issue to a third party who is in possession of the taxpayer's funds or property. This can be funds held by a general contractor to be paid to the taxpayer, but usually it takes the form of the IRS requesting the taxpayer's bank to empty the account and turn the proceeds over. Although levies can be reversed, the stress and immediate financial damage to taxpayers can be immense. When tax debt exceeds $50,000, the IRS may also move to revoke a taxpayer's passport.

The Massachusetts DOR has similar powers compared to the IRS. It can and will file liens, impose levies, and approach employers for garnishments. The Massachusetts DOR does not have the power to mess with a taxpayer's passport, but it has the power to block the renewal of – or outright revoke – state-issued licenses. This is a general power that applies to pretty much every license that can be issued to a taxpayer, including state professional licenses and certifications. It also encompasses Massachusetts driver's licenses.

INSTALLMENT AGREEMENT OFFSET

Although the IRS and Massachusetts DOR can pursue any number of aggressive actions in collections, these powers normally aren't exercised if the taxpayer comes forward and enters into a voluntary agreement to make periodic payments. The issue with multiple jurisdictions is this: Which revenue authority should be given priority?

A voluntary agreement to pay taxes is called an installment agreement. Installment agreements with either the IRS or the Massachusetts DOR follow the same general principles in that the revenue authority will look at the taxpayer's available equity in assets, available monthly income, and regular expenses. The installment agreement monthly payment is based on an analysis of these numbers which more or less reflects the taxpayer's ability to pay.

In an installment agreement, the IRS's internal procedures require it to give some allowance for the taxpayer to pay state debt. How much of this debt can be counted as part of the allowable expense formula sometimes depends on when the debt is formally assessed. If the IRS lien has priority that is equal to or greater than any state lien – which is often the

case – it may only give a partial expense credit for a state installment payment obligation. If the state has priority, however, the IRS may allow the entire state installment plan payment to be treated as a qualifying expense. This means if the IRS has priority over the state liens, it may be advisable to first approach the IRS with an installment agreement offer to avoid both revenue agencies trying to collect the same available funds.

Although there is some published guidance in Massachusetts, the DOR does not have as much in terms of guidelines relative to the IRS in how installment plans are evaluated. For this reason, it is somewhat unclear whether the Massachusetts DOR will give full credit to an IRS installment plan obligation in computing a taxpayer's ability to pay.

STATUTE OF LIMITATIONS CONSIDERATIONS

Both Massachusetts and the IRS are constrained by something called the statute of limitations on collections which bars them from being able to collect debt after a certain number of years. Assuming a tax is assessed, the IRS and Massachusetts only have ten years to take various collection actions against the taxpayer personally.

With federal income tax debt, any liens filed against the taxpayer or their property become unenforceable once the statute of limitations is up. In Massachusetts, if tax liens are filed against property owned by the taxpayer, the DOR's position is that these liens can be refiled after the ten-year statute of limitations on collections has expired. The DOR also will frequently request that a taxpayer consent to extend the statute of limitations on collections as a condition to granting an installment agreement. In contrast, the IRS rarely asks for such an extension when it enters into installment agreements.

It is also important to note that many states do not have a statute of limitations on tax collections at all. In any event, state tax debt may have a significantly longer life relative to federal tax debt.

SETTLEMENT POTENTIAL

Because the statute of limitations on collections is limited, and because installment obligations are constrained by the taxpayer's ability to pay, the IRS and Massachusetts DOR have incentive to settle tax debts in some cases for less than the full amount owed. Revenue authorities may settle in this manner by accepting partial-payment installment agreements in which the agreed-upon payments will not cover the entire liability by the time the statute of limitations expires. Alternatively, the revenue authority may consider an up-front payment in something called an offer in compromise. Obtaining either of these workout options can be difficult.

The IRS has more published guidance on its requirements for evaluating offers in compromise relative to the available information put out by the Massachusetts DOR. For this reason, a qualified advisor equipped with the relevant facts should be able to reasonably estimate whether the IRS will accept an offer based on their own internal guidelines. Alternatively, whether an offer to the Massachusetts DOR will be accepted is less certain because the state retains more administrative discretion over cases. Additionally, Massachusetts requires all offers approved by the DOR in which the taxpayer's liability is reduced by more than half or greater than $20,000 to be personally reviewed by the Attorney General's Office.

Tax debts supported by federal or state court judgements are not eligible for compromise in almost all cases.

Taxpayers lastly need to take into consideration the type of debt they are looking to compromise. Tax debts supported by federal or state court judgments are not eligible for compromise in almost all cases. Taxes that were originally based on amounts withheld on behalf of others, such as employee payroll taxes or sales tax withholdings, are also not eligible for compromise. **FT**

Negligence - An Introduction to Causes of Action

by Michael E. Brangwynne, Esq. | 617-336-2281 | mbrangwynne@fletchertilton.com

This is the fourth article in a series on the circumstances that can give rise to a civil lawsuit. Earlier articles in the series can be found on Fletcher Tilton's website under ARTICLES

NEGLIGENCE GENERALLY

In the last two installments of this series, we saw the importance of incorporating and obtaining appropriate business liability insurance to protect both personal and corporate assets from exposure to liability based on the careless acts of employees. You may be wondering what must be proven by an aggrieved party to recover damages for such careless acts — in other words — what are the elements that make up the cause of action.

Negligence is a broad and long-recognized cause of action under which an aggrieved party — the plaintiff — may recover damages if he can prove that (1) the defendant owed him a duty of care, (2) the defendant breached that duty by failing to act in a reasonable, careful manner, (3) the defendant's violation of his duty of care caused the plaintiff harm, and (4) damages were sustained.

As we saw earlier, based on the principle of respondeat superior, if negligence is proven against an employee and the employee was acting within his scope of employment, then both the employee and his corporate employer will be held liable.

As with most other causes of action, there are affirmative defenses to a claim for negligence. One of the most common is the defense of comparative negligence. This occurs when the plaintiff — the individual who has suffered harm and has made a claim against the defendant — was also acting in a careless manner that contributed to his injury. Under Massachusetts law, the plaintiff's total recovery is reduced in proportion to his share of fault. If the plaintiff is found to be 51% or more responsible for his injuries, he is completely barred from recovery.

By way of example, if Mr. Pedestrian suffers injuries while crossing the street when he is struck by a delivery van operated by Mr. Driver, who is exceeding the posted speed limit by 15 mph, Pedestrian could file a lawsuit against Driver for negligence and could also name Driver's employer, Delivery Corp., as a defendant if Driver was operating the delivery van within the scope of his employment.

The defendants (Driver and Delivery Corp.) might assert, as an affirmative defense, that Pedestrian did not look before crossing the road and was listening to his headphones on full volume so did not hear Driver approaching. If a jury found that Driver was negligent but that Pedestrian was 25% at fault for his own injuries, Pedestrian's total damages recovery against the defendants would be reduced by 25%.

If Pedestrian does establish that Driver was acting negligently and that he was acting within the scope of his employment, then Driver and Delivery Corp. would be jointly and severally liable. Pedestrian will be paid his total damages award only once, but joint and several liability means that Pedestrian can seek payment of his damages from Driver, Delivery Corp., or both. Typically, the employer would be the party with "deeper pockets" — not to mention the party more likely to have a general liability insurance policy — and therefore Pedestrian is much more likely to seek payment from Delivery Corp.

Negligence is a common cause of action asserted against individuals and businesses by third parties. By exercising proper care in our actions and strongly encouraging the same in our employees, we can further mitigate against the risk of exposure to liability. FT

UPCOMING WEBINARS

Trust & Estate Basics for CPAs & Financial Planners
with attorneys Michael Duffy, Dennis Gorman, and Brittany Bergeron

Wednesday, May 26, 2021 | 9:30-11:30 a.m. | Live Webinar

Impact Tax Ethics for CPAs with attorney Michael Duffy

Wednesday, June 9, 2021 | 9:30-11:30 a.m. | Live Webinar

Estate Planning with attorney Michael Lahti

Tuesday, May 11, 2021 | 10:00-11:30 a.m. | Live Webinar
Tuesday, June 1, 2021 | 10:00-11:30 a.m. | Live Webinar
Tuesday, July 20, 2021 | 10:00-11:30 a.m. | Live Webinar
Tuesday, August 3, 2021 | 10:00-11:30 a.m. | Live Webinar
Tuesday, August 31, 2021 | 10:00-11:30 a.m. | Live Webinar

For details and registration, visit FletcherTilton.com/seminars

FIRM NEWS

FLETCHER TILTON WINS "BEST LAW FIRM" DESIGNATION IN BEST OF CENTRAL MA READER'S CHOICE CONTEST

17,960 Telegram & Gazette/LocaliQ readers voted in the 2020 Best of Central MA Contest, casting a total of 324,000 votes. Fletcher Tilton PC garnered 383 votes, making the firm first place winner in the category of "Best Law Firm."

Congratulations to all our legal professionals whose high quality work inspired T&G readers to vote for us—you are all winners! And "Thank you" to everyone who voted—your recognition inspires us.

RECOGNIZED BY 2021 EDITION OF *BEST LAWYERS®*

Six Fletcher Tilton attorneys have been recognized in the 2021 edition of *Best Lawyers®*.

l to r: **Richard Barry, Jr.** - *Trusts & Estates,* **Mark Donahue** - *Real Estate Law,* **Dennis Gorman** - *Tax Law and Trusts & Estates,* **Frederick Misilo, Jr.** - *Elder Law,* **Phillips Davis** - *Corporate Law,* **Anthony Salvidio** - *Commercial Finance Law.*

Recognition by Best Lawyers is based entirely on peer review. Best Lawyers employs a sophisticated, conscientious, rational, and transparent survey process designed to elicit meaningful and substantive evaluations of the quality of legal services.

Congratulations to all!

FLETCHER TILTON EARNS "BEST LAW FIRM" DESIGNATION

Fletcher Tilton has once again earned the U.S. News – Best Lawyers® "Best Law Firms" ranking for 2021. Congratulations to all of our legal professionals that work so hard to earn this prestigous designation.

FLETCHER TILTON PC IS PLEASED TO ANNOUNCE BRIAN J. COUGHLIN AND ADAM C. PONTE HAVE RECENTLY BEEN NAMED DIRECTORS OF THE FIRM

Brian J. Coughlin is a Corporate Immigration Attorney at Fletcher Tilton PC. He has practiced immigration law for the past fifteen years, assisting employers of all sizes and across industries, including manufacturing, IT, custom engineering, media, and healthcare. Mr. Coughlin's practice encompasses all aspects of U.S. immigration law, as related to employment authorization, company policy drafting, employee training, and general enforcement and regulatory compliance issues. He also specializes in immigration due diligence and risk management in connection with corporate mergers, acquisitions, restructuring, and startups. Mr. Coughlin regularly assists clients in the preparation of employment-based and family-based immigrant visa petitions, applications for U.S. lawful permanent residence, and all categories of nonimmigrant visa petitions.

Adam C. Ponte is a Commercial Litigation Attorney at Fletcher Tilton PC and manages the firm's Boston office. His practice is focused on complex civil litigation where he represents businesses and individuals in legal matters such as business litigation, construction disputes and risk management, real estate disputes, and employment litigation. He also handles trust and estate litigation, and has represented trustees and beneficiaries before various probate and family courts. In his construction practice, Mr. Ponte negotiates both commercial and residential construction agreements and litigates on behalf of developers, owners, and contractors. He counsels clients on numerous construction contracts, including those provided by the American Institute of Architects (AIA), Design-Build Institute of America (DBIA) and ConsensusDocs. Mr. Ponte also handles licensing, zoning, and permit matters, including applications before the Massachusetts Alcoholic Beverages Control Commission.

FLETCHER TILTON RECEIVES CERTIFICATE FOR OUTSTANDING SUPPORT

Fletcher Tilton was presented with a certificate for outstanding support of the Marine Corps *Toys for Tots* Program by the Worcester Detachment of the Marine Corps League. Pictured l-r: Atty. **Mark Donahue**, Paralegal **Renee Tierney**, and, from the Toys for Tots Committee, **Bob Bilodeau**. Toys for Tots helps bring the joys of the holidays to less-fortunate children.

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