LAW360 Tax Authority

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Green Book Proposal Could Pave Way For More IRS Penalties

By **David van den Berg**

Law360 (March 24, 2023, 8:25 PM EDT) -- The Internal Revenue Service would likely impose more civil penalties on taxpayers than it does now if the Biden administration's recently revived proposal to change requirements for supervisory approval of penalties at the agency were enacted.

Changes in the 2024 fiscal year Green Book, including the elimination of some supervisory approval requirements and an expansion of IRS officials' authority, are likely to increase the number and amount of penalties asserted as well as disputes over penalties, practitioners told Law360. The Green Book details the tax proposals in President Joe Biden's budget.

In proposing to end some supervisory approval requirements for IRS penalties, the Biden administration said court decisions had created uncertainty about the required time for approval and who is qualified to give approval. (Sarah Silbiger for The Washington Post via Getty Images)

"I think that there is going to be an increase in penalty litigation because I think you will have more penalties being assessed that are perhaps assessed without necessarily weighing the gravity of the situation or the specific circumstance that's coming before the reviewer," said Chaya Kundra of Kundra & Associates PC.

Under Internal Revenue Code Section 6751(b), penalties generally can't be assessed unless the IRS worker making the initial determination to impose the penalty gets approval in writing from their immediate supervisor or a designated higher-level official. There are some exceptions, including penalties for failure to file returns or pay taxes. Congress enacted the **written supervisory approval requirement** in the IRS Restructuring and Reform Act of 1998 .

The fiscal 2024 Green Book calls for dropping the approval requirement for accuracy-related penalties under IRC Sections 6662 for understatements and 6662A for understatements related to reportable transactions. The requirement would be dropped for fraud penalties under Section 6663 .

The Green Book proposal also would expand who can sign off on penalties, giving that power to any supervisory official. Further, the proposal would clarify that penalties can be approved any time before issuance of a penalty notice that is subject to U.S. Tax Court review, and it would permit the agency to raise penalties in the Tax Court following supervisory approval if taxpayers petition the court, according to the Green Book. The proposal is expected to raise about $1.5 billion over a decade, according to the U.S. Department of the Treasury.

The same proposal appeared in the fiscal year 2022 Green Book. Both Green Books said recent court decisions had created uncertainty, including about the required time for approval and who is qualified to approve penalties. Many judicial decisions barred penalties that supervisors had approved before assessment and before any chance for judicial review, and when supervisory approvals didn't meet court-created deadlines, penalties were barred without any consideration given to whether they were proper under facts of the specific cases, according to the Green Books.

The Tax Court and multiple federal appeals courts have taken different approaches in their decisions on penalty challenges. Practitioners who spoke with Law360 said implementation of the proposal could benefit the IRS by providing nationwide clarity but would also lead to more penalties being imposed.

Kevin Spencer of McDermott Will & Emery LLP told Law360 he'd expect more instances where the IRS could assert penalties, leading to more amounts collected by the government, if the Green Book proposal were implemented.

"It's clear that … whoever scored this believes — and I agree with them — that by clarifying this language and changing [Section] 6751, they're expecting an increase in civil tax penalties," he said.

In the 2021 fiscal year, the IRS assessed nearly 41 million civil tax penalties valued at $37.3 billion, according to agency data. For individual, estate and trust income tax penalties, 788,243 of them were accuracy penalties, including for negligence, substantial understatement of income tax, and understatement of reportable transactions under Section 6662A. Just under 1,300 individual, trust and estate income tax civil penalties were for fraud, according to the IRS, and just over 17 million of the nearly 41 million individual, estate and trust income tax penalties were for failure to pay, according to the data.

Accuracy penalties are the largest portion of penalties subject to deficiency procedures, which means taxpayers can challenge them in the Tax Court before paying them, noted Ajay Gupta of the Moore Tax Law Group LLC. Under the Biden administration's proposal, for assessable penalties — those not subject to Tax Court review — written supervisory approval could occur any time before their assessment, and it "would become a rubber-stamp requirement," Gupta said.

Litigation regarding penalty approval goes back years. In 2017, the Second Circuit reversed a 20% accuracy-related penalty in Jason Chai v. Commissioner, **saying the IRS** had failed to show it obtained managerial approval for the penalty when sending its initial bill. Shortly thereafter, in a supplemental opinion in Graev v. Commissioner, the Tax Court said that the IRS must follow managerial approval requirements in Section 6751(b) and that it bears the burden in court of proving it has.

In 2019, in Clay v. Commissioner, the Tax Court also **tossed penalties** the IRS sought, saying an agency supervisor hadn't approved them as needed until it was too late. Earlier that year, however, the Tax Court in Palmolive Building Investors v. Commissioner **rejected Palmolive's argument** that the agency failed to follow its own procedures in asserting penalties.

Three circuits have reversed the Tax Court on penalty matters. In March 2022, a Ninth Circuit panel majority in Laidlaw's Harley Davidson Sales Inc. v. Commissioner overturned a Tax Court decision that tossed out a $10,000 penalty against the Harley dealership, saying an IRS supervisor hadn't provided written approval for the penalty. The majority ruled a 30-day letter threatening the penalty wasn't an initial determination requiring supervisory approval under the tax code, as the Tax Court had said it was.

Also in 2022, an **Eleventh Circuit panel** in Burt Kroner v. Commissioner reversed a Tax Court decision barring the IRS from imposing penalties on a man's $25 million in transfers, saying a supervisor didn't have to approve the agency's penalties until they were assessed. As with the Laidlaw case, the Tax Court had found the 30-day letter from the agency proposing tax adjustments and penalties was an initial determination requiring supervisory approval, and the appeals court disagreed.

Earlier this year, the Tenth Circuit **reversed a Tax Court finding** that the IRS had failed to comply with the approval requirement for a civil fraud penalty and remanded the matter for the Tax Court to determine the taxpayer's liability for the penalty. The Tenth Circuit cited the Ninth and Eleventh Circuits, saying supervisory approval wasn't needed until formal determinations were communicated to taxpayers, as well as the Second Circuit, saying Section 6751(b)(1) allows supervisory approval at the last step in the determination process.

With its Green Book proposals, the Biden administration is removing any lingering uncertainty and siding with federal circuits that have reversed the Tax Court, Gupta said.

"The Ninth and the Eleventh Circuits have tended to read the provision more or less in line with what the administration's proposal is," he said.

Clarity is needed from Congress regarding supervisory approval of penalties, said Megan Brackney of Kostelanetz LLP.

"There's been so much litigation around the timing of the approval, and it is confusing, and I think it's burdening the courts, and it's creating unnecessary disputes," she said.

Brackney said it's her sense that the IRS asked for the Green Book ideas and finds it annoying to have to consistently address the supervisory approval rule, especially when the agency is uncertain how it will be enforced in any given case, which is fair.

Dropping supervisory approval requirements for the 6662, 6662A and 6663 penalties could be problematic, she suggested, because those all require the agency to make added determinations beyond looking at numbers and seeing something came in late.

"There should be managerial approval for those penalties, especially fraud," she said.

--Additional reporting by Vidya Kauri, David Hansen, Theresa Schliep and Anna Scott Farrell. Editing by Aaron Pelc and Khalid Adad.