COURT HAS NO MERCY FOR BOTCHED ESTATE TAX PAYMENT EXTENSION

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In a recent appellate case, the 9th Circuit Court of Appeals upheld the trial court in applying failure to pay penalties for late estate taxes, even though a request for extension of payment could be inferred from an extension request filed by the taxpayer.

FACTS. An estate executor hired an accountant to prepare a federal estate tax return. Due to the inability to obtain the release of liquid funds in a timely manner to pay the tax, the accountant submitted a Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer Taxes). This Form allows for an automatic extension of 6 months TO FILE, and the taxpayer can further use it to request an extension of time TO PAY of up to 12 months. The Form submitted to the IRS did not complete Part III of the Form which is entitled 'Extension of Time to Pay." It appears that the estate did not check any of the boxes in Part III, and the field labeled "Enter extension date requested" was left blank. However, the accountant did include a letter with the Form indicating that an extension of time to pay was needed and providing the reason, but again, no specific date for the extension to run to was included. Interestingly, the request estimated the tax due at $131,327 - when the return was ultimately filed the actual tax due was $1,684,408. Due to late payment, a penalty of $58,954 was imposed, along with interest of $69,801. The taxpayer raised several reasons why the penalty should be abated - principally the doctrine of substantial compliance, collateral estoppel, and reasonable cause. The court found that none of these reasons justified removing the penalty.

ANALYSIS. The estate put forth several interesting reasons why the penalty should be abated. Unfortunately, none of them carried the day.

A. DOCTRINE OF SUBSTANTIAL COMPLIANCE. The doctrine of substantial compliance is an equitable doctrine designed to avoid hardship in cases when a party has done all that can be reasonable expected to meet statutory or regulatory requirements. The estate argued that it had substantially complied with the regulations governing payment extension requests by reason of its partially complete Form and accompanying letter.

In regard to statutory prerequisites, the doctrine cannot be used to defeat the policies of the underlying statutory provisions. *Sawyer v. Sonoma County*, 719 F2d 1001, 1008 (9th Cir. 1983). According to the appellate court, the regulation governing payment extensions is designed to provide the IRS with the information necessary to determine whether an extension of time to pay is warranted and, if so, to determine a reasonable length for that extension. By failing to include a period for the extension request, the court found that use of the doctrine would defeat these policies and thus the doctrine could not be applied.

B. ESTOPPEL. The estate also argued that the IRS had an obligation to inform it that the payment extension was request was deficient and to provide an opportunity to amend it, or mitigate the penalty (presumably by prompt payment). By not doing so, the IRS was equitably estopped from asserting the penalty.

However, to assert equitable estoppel successfully, the taxpayer would need to show the government engaged in affirmative misconduct beyond mere negligence (among other required elements). The Court noted that the estate could not show any affirmative misconduct by the IRS, such as a deliberate lie or a pattern of false promises. Indeed, the Court noted there was no IRS conduct at all – simply inaction. Thus, that argument was rejected.

C. REASONABLE CAUSE. Code §6651(a)(2) provides that a late payment penalty will not apply if the failure to pay is “due to reasonable cause and not due to willful neglect.” The estate argued that it acted reasonably because it relied on an accountant to prepare and submit the extension request.

The appellate court noted that it found no cases addressing whether a taxpayer's reliance on an accountant to obtain an extension of time to pay taxed owed constitutes reasonable cause under Code §6651(a)(2). However, the court noted that in *United States v. Boyle*, 469 US 241 (1985), the Supreme court denied a reasonable cause defense for reliance on an attorney to timely file an estate tax return when the return was filed late. The appellate court found "no reason to distinguish between reasonable cause for a failure to timely file an estate tax return and reasonable cause for a failure to timely pay an estate tax" and thus disallowed the reasonable cause claim.

COMMENTS/LESSONS

A. Based on this opinion, arguments of reliance on counsel or an accountant to abate a late penalty will be as difficult to prevail upon as a penalty for late filing. Of course, a negligent attorney or the accountant may have liability to the taxpayer for the penalty – but that obviously is not as favorable as to both the taxpayer and the advisors escaping without liability.

B. If you are submitting a Form 4768, fill in all the requisite fields! If an extension for time to pay is included, at a minimum make absolutely sure that a time period is filled in.

C. One can wonder whether both the IRS and the courts came down on so hard on the taxpayer here due to the actual tax due turning out to be over 12 times the size of the estimate of the tax included on the extension form. We will never know, but it is eye-raising and thus may have had some impact on the courts and the IRS. Since interest on an allowed late payment will be based on the actual tax due and not the estimate used on an extension request, there usually is no upside to being stingy with the estimate of tax that will eventually be due other than the possibility that the IRS will be more likely to grant an extension when the estimated tax amount is small.

Baccei v. U.S., 107 AFTR2d 2011-xxxx (CA9)

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