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PRACTICE POINT

The First-Time Abatement Policy—Harsh Realities and Strategic Considerations

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First-Time Abatement

The IRS implemented a first-time abatement (FTA) policy in 2001[1] to provide relief from penalties in a single year for failure to file,[2] failure to pay,[3] or failure to deposit[4] under certain circumstances. The data suggest that the FTA policy has been either unnoticed or underutilized among eligible taxpayers.[5] Further, the National Taxpayer Advocate has criticized the policy for failing to fulfill its purpose.[6] Today, however, the effects of the COVID-19 pandemic and administrative delays within the IRS have given the FTA policy greater significance.

To qualify for relief under the FTA policy, a taxpayer must generally show three things: filing compliance, payment compliance and a clean penalty history. Specifically, taxpayers must show that they (i) were not required to file a return or have no prior penalties for the preceding three years;[7] (ii) have timely filed (or filed a valid extension) for all currently required returns; and (iii) have paid or arranged to pay any tax currently due.[8]

These bright-line criteria for relief are both clear and easily understood, but they also can lead to harsh and seemingly unfair results in certain situations. A recent district court decision from the District of Maryland illustrates the harsh realities of the FTA policy and provides an opportunity to revisit a few practical takeaways to consider when requesting FTA relief.

[1] IRM 20.1.1.3.3.2.1 (10-19-2020).
[2] §§ 6651(a)(1), 6698(a)(1), or 6699(a)(1).
[3] §§ 6651(a)(2) and/or 6651(a)(3).
[4] § 6656.
[5] For tax year 2019, penalties for failure to file, failure to pay and failure to deposit (i.e., the penalties covered by the FTA policy) comprised 95.5% of all civil penalties assessed against individuals. Of those, only about 12 percent of the failure to file penalties and 12 percent of the failure to pay penalties were abated. 2019 IRS Data Book, Table 17 *Civil Penalties Assessed and Abated, by Type of Tax and Type of Penalty*.
[6] The National Taxpayer Advocate noted fewer penalty abatements in 2010 than in the years prior to implementation of the FTA policy and also noted a decrease in penalty abatements in the years 2005-2009 even though penalty assessments increased, demonstrating that the FTA policy and other penalty relief options were not fulfilling their intended purpose of encouraging voluntary compliance. *See* National Taxpayer Advocate, 2010 Annual Report to Congress, pp. 202-203 and Figure 1.14.1 *FTF, FTP, and FTD Penalty Assessment and Abatement Counts, FY 2005-2009*.
[7] IRM 20.1.1.3.3.2.1(4) (10-19-2020).
[8] IRM 20.1.1.3.3.2.1(2) (10-19-2020). The FTA policy only provides relief for tax periods ending *after* December 31, 2001.

Oosterwijk v. United States

In the *Oosterwijk* case,[9] two married taxpayers sought a refund for delinquency penalties after their accountant and return preparer failed to timely e-file an extension request. The district court ultimately rejected the taxpayers' request for "reasonable cause" abatement of the penalties.[10] Aside from the taxpayers' contentions and the court's conclusion, this article focuses on a different aspect of the case—a "road not taken," so to speak. The taxpayers did not request an abatement of their delinquency penalties under the FTA policy. As explained below, their case is instructive regarding the problems with current FTA policy.

In 2017, the Oosterwijks decided to sell a long-held family-owned wholesale meat business for several millions of dollars. That year, they also decided to request a filing extension by having their accountant file Form 4868, *Application for Automatic Extension of Time to File U.S. Individual Income Tax Return* ("Extension Request"), before filing their Form 1040. The Oosterwijks' accountant assured them he would e-file the Extension Request before the April 17, 2018 filing deadline and their balance due of $1.8 million would automatically be debited from their bank account. After the filing deadline passed, the Oosterwijks noticed their bank account had not been debited and learned on April 30 that their accountant had failed to e-file the Extension Request. The accountant advised the Oosterwijks that they themselves could immediately file an Extension Request with the $1.8 million payment, and that such a request and payment would extend their filing deadline to October and halt the accrual of late-filing penalties. On this advice, the Oosterwijks mailed a paper Extension Request and a check for $1.8 million to the IRS. The payment posted on May 4, 2018, and the Oosterwijks e-filed their 2017 Form 1040 nearly two months later on June 29, 2018. The IRS processed the return on September 10, 2018.

The IRS assessed three separate delinquency penalties. When the Oosterwijks' 2017 return was finally processed in September, the IRS assessed a failure to file (FTF) penalty of $256,916.36.[11] Contrary to their accountant's advice, the Oosterwijks' filing of the Extension Request did not halt the accrual of the FTF penalty; instead, the penalty continued to accrue from the April 17, 2018 filing deadline through June 29, 2018 when the Oosterwijks e-filed their return. On the October 15, 2018 extended filing deadline, the IRS also assessed an additional FTF penalty of $8,859.19 and a failure to pay (FTP) penalty of $8,859.19.[12] In total, the Oosterwijks owed $274,634.73 in penalty payments.[13]

At this point, it is worth asking why the taxpayers did not request abatement of the penalty amounts under the FTA policy. There are several lessons to be learned from this case, but the most important is that the Oosterwijks were not eligible to request FTA relief because they had *already incurred a $7 late payment penalty in 2014*, which had been waived under the FTA policy.[14] The Oosterwijks thus technically failed to satisfy the "clean penalty history" requirement for FTA eligibility. For roughly the price of a footlong Italian

[9] *Oosterwijk v. United States*, Civ. No. CCB-21-1151, 129 A.F.T.R. 2d 2022-xx, (D. Md. Jan. 27, 2022).
[10] *Id.*, at 10-12 (citing and quoting *United States v. Boyle*, 469 U.S. 241 (1985)).
[11] The FTF penalty is calculated by "add[ing] to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate … ." § 6651(a)(1).
[12] The FTP penalty is calculated by "add[ing] to the amount shown as tax on such return 0.5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate … ." § 6651(a)(2).
[13] After a conference with the IRS Independent Office of Appeals, an Appeals Officer agreed to abate $132,887.78 of the FTF penalty and $4,429.59 of the FTP penalty.
[14] *Oosterwijk*, *supra* note 9, at 1.

B.M.T., the Oosterwijks exhausted their FTA eligibility for the years 2014 through 2017 and therefore were liable for hundreds of thousands of dollars in delinquency penalties.

This is an undeniably harsh result, and the FTA policy arguably failed in this case to serve its purpose of providing relief to taxpayers with a nearly flawless compliance history. The IRS maintains that penalties promote voluntary compliance "if they support belief in the fairness and effectiveness of the tax system."[15] The IRS Office of Chief Counsel also acknowledges that the FTA policy is intended to encourage voluntary compliance.[16] These statements affirm that a fair tax system is a better tax system.

To promote fairness, it seems prudent to consider ways the FTA policy might be easily adjusted to avoid overly harsh results like those suffered by the Oosterwijks. The inclusion of a *de minimis* carveout (defined either by dollar amounts or percentage of income tax owed) could help excuse relatively minor penalties incurred during the three-year period preceding the penalized year. In the *Oosterwijk* case, a *de minimis* carveout would have excused their prior $7 delinquency penalty from 2014 and allowed them to request a waiver under the FTA policy of the significantly larger penalty they incurred in 2017. The FTA policy's "clean compliance history" requirement could also be bifurcated, so that taxpayers would only be eligible for a waiver of penalties under the FTA policy if they had not incurred the *same type* of penalty during the preceding three years. For example, a taxpayer who incurred an FTP penalty in 2014 would not be eligible for waiver of an FTP penalty in 2017 under the FTA policy but would be eligible for waiver of an FTF penalty. The key point here is that the *Oosterwijk* case illustrates how the current FTA policy can lead to unfair results in some situations. If our tax system functions optimally when taxpayers perceive it as fair, then the FTA policy's harsh realities deserve re-consideration.

Practical Notes

Setting aside the *Oosterwijk* decision, a few practical considerations are worth noting. First, the FTA policy only provides relief from income tax penalties against individuals and certain entities for *failure to file* under sections 6651(a)(1), 6698(a)(1), or 6699(a)(1); *failure to pay* under sections 6651(a)(2) and/or 6651(a)(3); and *failure to deposit* under section 6656. The FTA policy does not apply to gift and estate tax penalties or penalties related to foreign information returns. Taxpayers facing penalties not covered by the FTA policy must seek other alternatives for relief, such as abatement due to reasonable cause (the relief sought but denied in the *Oosterwijk* case).

Second, as a strategic matter, if a taxpayer has a strong argument for relief due to reasonable cause, it is generally preferable to seek relief by requesting abatement based on reasonable cause rather than under the FTA policy. By relying on reasonable cause instead of FTA relief, the taxpayer preserves eligibility for FTA relief in a future year when unforeseen issues may arise. As the *Oosterwijk* case shows, it is best to save FTA eligibility "for a rainy day."

Third, there are several ways to make a request for abatement under the FTA policy, each with potential advantages depending on the circumstances. Tax practitioners may make a request by phone by calling

[15] *Encouraging Voluntary Compliance*, IRM 20.1.1.2.1(10) (Nov. 25, 2011).

[16] The Commissioner has authority to waive penalties for classes of taxpayers under the first time abate policy in the exercise of enforcement discretion and based on a policy of enhancing voluntary compliance. Automation of the existing first time abatement policy does not affect the Commissioner's ability to exercise enforcement discretion with respect to the penalties included in the policy.
IRS Chief Counsel Memorandum CC:PA:02:HMarx (Sept. 28, 2017).

the IRS's practitioner priority line[17] or a specific compliance unit. By phone, IRS personnel are usually able to review the taxpayer's account, determine if the taxpayer satisfies the FTA policy criteria, and grant the waiver during the call.

Practitioners may also submit a letter by mail to request relief under the FTA policy. The letter should include all relevant information, including the taxpayer's name, identification number, the tax year/period, the relevant tax form submitted and the penalty type(s) and amount(s). The letter should clearly state that the client meets the FTA policy's criteria and should include client transcripts that prove filing and payment compliance and a clean penalty history. Calling the IRS is often preferable when requesting FTA relief, because the IRS can remove the penalties quickly during the phone call. Nonetheless, the IRS will require a letter or other written request if the penalty amount is too large for the IRS to abate over the phone.

Finally, if the IRS denies a request for abatement under the FTA policy, there is essentially nothing that can be done to protest or appeal the determination. The FTA policy does not create an enforceable right to relief as it is set forth only as IRS policy within the Internal Revenue Manual.[18] The FTA policy is essentially an olive branch extended in the IRS's discretion and not appealable as a matter of right unless and until it is codified by statute or included in regulations. ■

[17] Practitioners with proper taxpayer authorization can call the Practitioner Priority Service line at (866) 860-4259 to request penalty abatement for a client over the phone.

[18] IRM 20.1.1.3.3.2.1 (10-19-2020). The IRM administrative policies are neither mandatory nor binding on the IRS.